



**UNITED STATES AGENCY FOR
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B.

ACRONYMS and ABBREVIATIONS

ABA/CEELI	American Bar Association/Central and Eastern European Law Initiative
ACDI/VOCA	Agricultural Cooperatives Development International/ Volunteers in Overseas Cooperative Assistance
ACILS	American Center for International Labor Solidarity
ACJ	Association of Croatian Judges
ADF	America's Development Foundation
AED	Academy for Educational Development
AIR	Association of Independent Radio
ASB	Arbeiter-Samariter Bund/Deutschland A.V. (of EU)
BiH	Bosnia and Herzegovina
BPRM	Bureau of Population, Refugees and Migration (of State Department)
CCI	Center for Civic Initiatives
CCN	Croatian Commercial Network (TV)
CDC	Citizens Democracy Corps
CEE	Central and Eastern European
CJA	Croatian Journalists Association
CPF	Croatian Privatization Fund
CROMAC	Croatian Mine Action Center
CSO	Civil Society Organization
CY	Calendar Year
Dayton Agreements	Dayton Peace Accords
DFID	Department for International Development (UK Ministry of Foreign Affairs)
EBRD	European Bank for Reconstruction and Development
Erdut Agreement	Basic Agreement on Reintegration of the Region of Eastern Slavonia, Baranja and Western Sirmium
E&E Bureau	Europe and Eurasia Bureau (of USAID)
EU	European Union
FDI	Foreign Direct Investment
FIAS	Foreign Investment Advisory Service
FLAG	Firm Level Assistance Group
FRY	Federal Republic of Yugoslavia
FSN	Foreign Service National
FY	Fiscal Year
GDP	Gross Domestic Product
GOC	Government of Croatia
GONG	Citizens Organized to Monitor Elections (Croatian CSO)
GLAS 99	Voice (Coalition of Croatian CSO)
HDZ	Croatian Democratic Union
HEP	Croatian Electric Power Company
HRT	Croatian Radio-Television
HT	Croatian Telecom (Hrvatske Telekomunikacije)
ICASS	International Cooperative Administration Support Services
ICNL	International Center for Not-for-Profit Law

ICT	Information and Communications Technology
ICTY	International Criminal Tribunal for the former Yugoslavia
IESC	International Executive Service Corps
IFC	International Finance Corporation
IFI	International Financial Institution
IMF	International Monetary Fund
IOM	International Organization for Migration
IR	Intermediate Result
IREX	International Research and Exchanges Board
IRI	International Republican Institute
IT	Information Technology
Kuna	Croatian Unit of Currency (\$1.00 = HRK 8.50 Approximately)
LGRP	Local Government Reform Program
MBACE	Masters in Business Administration Enterprise Corps
MCIP	Municipal Court Improvement Project
MOJ	Ministry of Justice, Administration and Local Government
MP	Member of Parliament
MPP	Mission Performance Plan
MPWRC	Ministry of Public Works, Reconstruction and Construction
NATO	North Atlantic Treaty Organization
NCSC	National Center for State Courts
NDI	National Democratic Institute
NGO	Non-Governmental Organization
NUT	Association of Independent Television
OPIC	Overseas Private Investment Corporation
OSCE	Organization for Security and Cooperation in Europe
OSI	Open Society Institute
PFP	Partnership for Peace (of NATO)
RAP	Return Assistance Program
RONCO	U. S. Contract Services Firm
SAA	Stabilization and Association Agreement (of EU)
Sabor	Croatian Parliament
SDF	Serb Democratic Forum (Local NGO)
SEAF	Small Enterprise Assistance Fund
SME	Small and Medium Enterprise
SO	Strategic Objective
TDA	Trade and Development Agency
TI	Transparency International
UI	Urban Institute
UNHCR	United Nations High Commission on Refugees
USAID	United States Agency for International Development
USD	United States Dollar
USDH	United States Direct Hire
USPSC	United States Personal Services Contractor
USG	United States Government
VAT	Value Added Tax
WB	World Bank
WL	World Learning, Incorporated
WL/STAR Network	Women's Leadership NGO (U.S. NGO)(Strategies, Training, Advocacy and Resources)

WTO

World Trade Organization

TABLE OF CONTENTS

PART I: SUMMARY ANALYSIS OF THE ASSISTANCE ENVIRONMENT AND RATIONALE FOR STRATEGIC CHOICES

	<u>PAGE</u>
A. Country Overview	6
B. U. S. Foreign Policy Interests	6
C. USAID Assistance	7
D. Overview of the Strategic Context	8
1. Country SWOT Analysis and Vision for Croatia 2005	8
2. The Economy	10
3. The Politics	12
4. Civil Society and the Media	13
E. Cross-Cutting Factors Affecting the Reform Process	14
1. The Regional Context	14
2. Conflict Vulnerability	15
3. Competitiveness	17
4. Gender	18
5. Corruption	19
6. Information and Communications Technology	21
7. Environment and Biological Diversity	21
F. Strategic Priorities	25
1. The Goal	25
2. Focus	25
3. Linkages Across Objectives	28
4. Basic Assumptions for Strategic Success	28
5. Sustainability	29
G. Customers and Partners	29

PART II: STRATEGIC PLAN

Strategic Objective 1.3: Growth of a Dynamic and Competitive Private Sector

A. Statement of Strategic Objective	31
B. Problem Analysis	31
C. Results Framework	34
1. Causal Linkages	34
2. Critical Assumptions	35
D. Progress to Date	35
E. Program Approaches	36
F. Development Partners	38
G. Sustainability	39

Strategic Objective 2.1: More Effective Citizen Participation and Improved Governance

A. Statement of Strategic Objective	41
B. Problem Analysis	41

1. Civil Society Organizations	41
2. Media	42
3. Local Government	42
4. Political Processes	43
5. Rule of Law	43
C. Results Framework	43
1. Causal Linkages	43
2. Critical Assumptions	44
D. Progress to Date	45
1. Civil Society Organizations	45
2. Media	45
3. Local Government	46
4. Political Processes	46
5. Rule of Law	46
E. Program Approaches	47
F. Development Partners	48
G. Sustainability	49

Strategic Objective 3.1: Accelerated Return and Sustainable Reintegration of War-Affected Populations

A. Statement of Strategic Objective	52
B. Problem Analysis	52
C. Results Framework	55
1. Causal Linkages	55
2. Critical Assumptions	56
D. Progress to Date	57
E. Program Approaches	58
F. Development Partners	59
G. Sustainability	60

Strategic Objective 3.4: Mitigation of Adverse Social Conditions and Trends

A. Statement of Strategic Objective	62
B. Problem Analysis	63
C. Results Framework	65
D. Progress to Date	66
E. Program Approaches, Development Partners, Sustainability	66

4.2: Cross-Cutting Programs

A. Anti-Corruption	67
B. Information and Communications Technology	68
C. Environment	69
D. Training	69

PART I: SUMMARY ANALYSIS OF THE ASSISTANCE ENVIRONMENT AND RATIONALE FOR STRATEGIC CHOICES

A. Country overview

In a very real sense, Croatia's journey to modern democratic nationhood and full participation in the global economy began in earnest in early 2000, after a decade of delay caused by conflict and political misrule. The breakup of Yugoslavia resulted in an independent Croatia in June 1991, but this important event was quickly followed by the outbreak of regional conflict in the Balkans that resulted in large-scale loss of life, massive displacement of population, significant destruction of property, and reduction in trade and industrial output.

The Dayton and Erdut peace accords of 1995 ended armed hostilities, and beginning in the mid-1990's Croatia enjoyed a period of economic growth fueled largely by increased consumption and expansive economic policies. But these trends proved unsustainable as the autocratic and highly nationalistic Government of President Franjo Tudjman distorted economic policy for his own and his party's political gain. The result was serious economic contraction in 1998 and 1999, accompanied by the collapse of much of the banking system and thousands of enterprises, both public and private. These events led in turn to high unemployment and other social, political and economic problems that had been festering for some time.

When President Tudjman died in December 1999, the forces of popular opposition to his policies were already well on the way to electing a reform-minded Parliament and coalition Government in January 2000, followed almost immediately by the election of Stipe Mesic, leader of a relatively small opposition party, to the Presidency. President Mesic's appeal was based on his promise to lead Croatia in an entirely new direction.

The events of the past year have created an exceptional opportunity for Croatia to begin participating fully in European and global institutions and to achieve sustainable economic growth. By reducing political risk and taking corrective policy actions and comprehensive structural reforms, Croatia can work for the first time toward acceptance into the European Union. Croatia's new commitments to stem corruption, to cooperate with the International Criminal Tribunal for the former Yugoslavia (ICTY), to cease disruptive financial payments to ethnic Croats in Bosnia, and to welcome Serb minority refugees and displaced persons back to their homes in Croatia help to fulfill agreements essential for acceptance by international institutions, investment by private entrepreneurs, and support from international lenders and donors, including USAID.

B. U. S. Foreign Policy Interests

The U.S. Government's foreign policy goal for Croatia, set forth in the U.S. Mission Performance Plan (MPP) for 2000, is to ensure that Croatia continues to take the necessary steps to take its place within the community of democratic nations, and to become a force for stability, peace and cooperation throughout Southeast Europe. The MPP sets four objectives that comprise the approach necessary to achieve this

goal: (1) full implementation of the Dayton and Erdut Agreements; (2) transition to a free-market economy; (3) increased domestic and regional stability; and (4) integration into Euro-Atlantic institutions.

Observers within and outside the country believe that Croatia could become a model for the rest of the troubled Balkans and contribute to European security and prosperity on which America's own security and prosperity depend. Stronger institutions that link to transnational needs and issues will further stability in Croatia and the region.

The U.S. Mission in Croatia collectively and cohesively encourages an open free market economy and a democratic political system based on international norms for broad-based public participation, protection of human rights, rule of law, freedom of speech and assembly, and transparency and accountability of Government.

C. USAID Assistance

USAID assistance to Croatia began on a modest level in 1993, focusing initially on humanitarian assistance to the war-affected population. After the Government of Croatia signed the Dayton Peace Accords (December 1995) and the Basic Agreement on the Region of Eastern Slavonia, Baranja and Western Sirmium (signed in Erdut, November 1995), USAID undertook a five-year Strategy to support three Strategic Objectives: return and reintegration of war-affected populations, financial sector reform; and strengthening of political processes and civil society. Work in financial sector reform was suspended in 1997 following an assessment that showed a lack of political will for reform on the part of the Tudjman Government. Assistance activities from that time until the 2000 elections focused almost exclusively on direct assistance to local governments, political parties, labor unions, media and to non-governmental organizations, avoiding support to the central Government. USAID's two key objectives during the 1997-99 period were to strengthen civil society and to support the return and reintegration of war-affected people. Progress was made in these areas, and USAID assistance is credited with a key role in promoting free and fair elections in early 2000 through its strong and effective support to political party strengthening, citizen election monitoring and information dissemination through a strengthened independent media. This Strategy will broaden and deepen those efforts while also expanding the program focus to include significant support to economic reform.

Despite recent changes in Croatia's policy directions and initial successes, enormous development problems confront the Government. USAID has played and can continue to play a pivotal role in Croatia's economic and political development. This five-year Strategy focuses on four Strategic Objectives aimed at economic growth, reintegration of war-affected populations, civil society and governance, and social reform programs. While graduation from USAID assistance is not foreseen at the end of this planning period, an assessment will be conducted during the last year to determine the extent and nature of future assistance.

D. Overview of the Strategic Context

• Country SWOT Analysis and Vision for Croatia in 2005

In preparation for developing this five-year Strategic Plan, USAID/Croatia conducted a collective staff review of the country's strengths, weaknesses, opportunities and threats (SWOT). While hardly rigorous or scientific, this exercise demonstrated significant consensus across three focus groups, each of which cut across technical orientations and included both professional and support staff. Participants viewed it as a useful exercise for determining the relevance of USAID's Strategy to the most significant challenges facing the country. The main conclusions of the SWOT analysis are summarized here:

a. Strengths

- Croatia's human resource capacity – highly educated, skilled people, many with direct ties to or experience in Western countries
- Geography – location, natural resources, coastline (tourist potential), beauty, proximity to western Europe
- Political orientation – reform-oriented and Western-oriented government and President
- Low absolute poverty level

b. Weaknesses

- Human resource constraints – unemployment, shortage of skills needed in a modern market economy (especially management), aging population, low productivity, poor working habits, high labor costs, waiting for others and “get rich quick” attitude, youth unprepared for IT economy, low secondary school enrollment
- Aftermath of the war – destruction, loss of production, land mines, delay in transition, unstable region, nationalism, focus on the past
- Poor investment climate, lack of competitiveness and of both domestic and foreign investment
- Lack of effective rule of law – ineffective judiciary, corruption, non-transparency
- Political inexperience of the new Government, fragility of the six-party coalition, inefficiency and high cost of bureaucracy, weakness of local governments

- Perception of poverty, reduced living standards compared with the past, income inequality

c. Opportunities

- Tourism sector, SME development, privatization, fiscal reform
- Croatia can be regional leader, force for stability and progress
- EU and NATO accession
- New legislation and enforcement to promote rule of law, more efficient social safety net
- Cooperation with the International Criminal Tribunal
- Foreign direct investment as stimulus for new jobs, skills, higher productivity, growth, improved environmental protection
- New attitude of hope, optimism

d. Threats

- High unemployment, labor instability, income inequality, large number of unemployed, poorly educated and un-engaged youth, emigration (brain drain), failure to create jobs
- Fast, non-transparent privatization and bankruptcies, corruption, organized crime
- Polarization, extreme right wing, possibility of HDZ resurgence
- Regional instability and potential for war

USAID staff also engaged in a consensus exercise aimed at developing a vision for what Croatia could achieve by 2005, the last year of this Strategic Plan, if the country succeeded in maximizing its strengths and opportunities, while simultaneously reducing the weaknesses and threats now facing it. The following bullets reflect the consensus of USAID/Croatia about that vision. It should be noted that in this exercise, the Mission did not limit itself to a description of results for which USAID will be accountable through achievement of Strategic Objectives or Intermediate Results. Rather, we simply envisioned a Croatia that the consensus opinion found to be achievable by the country itself, under optimistic but realistic circumstances and assumptions.

In USAID/Zagreb's vision, Croatia in 2005 will be:

- On a path of strong economic growth (5-6% annually) and reduced unemployment (from 22% to 10%);

- On track toward EU accession and NATO membership, with Croatia playing an increasing leadership role in Southeast Europe;
- Enjoying a better business environment, with a growing and increasingly competitive SME sector and greater competitiveness in key sectors such as tourism, agribusiness and information technology;
- Finished with a transparent and competitive privatization process;
- Achieving solid and sustainable gains in labor productivity, environmental protection and an efficient and well-targeted social safety net;
- Evidencing more mature political parties and leaders, with key political reforms completed
- Making objective information more broadly available to citizens through a more independent, balanced media;
- Demonstrating a more effective judiciary and regulatory structure, with checks and balances in place as well as reduced corruption and organized crime.

2. The Economy

Croatia in 2000 shows signs of great economic promise, but confronts serious obstacles in its efforts to become a competitive player in global, European and regional markets. Like other transition countries, Croatia must restructure and divest a large number of publicly owned economic assets, only a minority of which are economically viable. At the same time, the country needs to create a vast number of new laws, institutions and policies in order to function effectively as a market economy, while also correcting fiscal imbalances and devolving financial authorities to local and regional levels. The new Government, in power for less than one year, is attempting to bring about serious economic reform, but is constrained by the legacies left by the previous Government. The Tujman era was known for its centralized command of the economy, failure to check public-sector spending, lack of will to undertake basic reform and restructuring or encourage private entrepreneurship, and overall distortion of economic policies for political purposes. Debt and unemployment are particularly critical problems inherited by the new Government.

From 1993 to 1998, Croatia enjoyed economic growth fueled mainly by consumption (especially public-sector expenditure) that proved unsustainable. In 1998 and 1999, the economy was in a downward spiral and real GDP contracted. A number of banks failed as a result of politically motivated lending to unsound borrowers. Non-transparent and non-competitive privatization processes also led to a significant number of bankruptcies and unknown quantities of capital flight.

Unemployment in Croatia hovers around 22 percent, although this number may overstate joblessness by as much as 10 percent by failing to take into account the informal or “gray” economy. Unemployment will continue to grow as large state enterprises are restructured and privatized, and new job creation remains very low.

Foreign debt has climbed to more than USD 9 billion. GDP, at approximately \$20 billion, remains 30 percent below the 1990 level in real terms. Foreign direct investment is generally weak, buoyed by a few specific high-profile sales of state-owned assets, such as foreign investments in banks and Croatian Telecom; greenfield investment is almost non-existent. Complaints by potential investors include labor costs and taxes that are too high to be internationally competitive, complex and opaque administrative approvals, and an inefficient legal system that fails to resolve debt, bankruptcy and property issues on a timely basis.

Croatia's economy is dominated by the public sector, which accounts for 52 percent of GDP. The public sector wage bill consumes over 11 percent of GDP, compared with only 3.3 percent on average for transition countries and 4.6 percent for European countries. In 2000, the Croatian Government budget deficit is in excess of nine percent of GDP.

On the positive side, 2000 has brought Croatia the best tourism year since independence and a nine-percent increase in exports, primarily to Europe. With its entry into the WTO in December 2000, Croatia will have improved access to EU markets and should become somewhat more competitive in some export sectors. Consequently, exports should continue to be an important engine of growth over the near-term. If economic growth continues to be strong in EU countries, demand for Croatian exports should increase as well, since Croatia already derives about half of its export receipts from EU markets. Domestic demand has been surprisingly high due to consumer buying, but may not be sustainable because of rising unemployment. GDP growth in 2000 is anticipated to be 3.5 percent.

Retail price inflation is forecast at 6.0 percent in 2000, compared with 4.2 percent in 1999. The chief reason for this rise is increased international oil prices and domestic transport costs. A second negative factor is the strong U.S. dollar relative to the kuna in terms of internationally traded commodities. However, inflation is expected to moderate to about 5.0 percent in 2001.

The Government's economic program is centered on a plan to stimulate job creation, primarily by cutting taxes. However, the weak fiscal position of Government has prevented effective implementation of this policy. The planned reduction in the value-added tax (VAT), now 22 percent, has been deferred, but likely will be applied to some degree in 2001. Social expenditure cuts in areas that would hurt pensioners, low-paid workers and unemployed are not being undertaken in the face of public protest. Privatization transactions are driven by the need to finance short-term deficit requirements. On the block in 2001 will be a further share of Croatia Telecom (with a 35 percent interest already held by Deutsche Telecom), with plans for sale of some portions of the Hrvatska Elektroprivreda (HEP), the state electricity utility, and INA, the oil and gas monopoly. As many as 1,900 smaller state assets are currently being consolidated in the Croatian Privatization Fund and prepared for sale or liquidation, but it is believed that only about 300 of these are economically viable and attractive for foreign investment. The strength of one-time privatization revenues could permit the Government to continue running large budget deficits, but most large assets are scheduled to be sold off by 2003, and thus fiscal reform must remain a high priority. Furthermore, rapid sale of assets without transparent and competitive procedures can actually, result in reduced revenues and

discourage other foreign investment, while open and internationally competitive offerings take more time to prepare, creating difficult trade-offs for the Government.

The Government has not yet secured an IMF standby facility because of its slowness to undertake a serious structural reform program and to reduce the fiscal deficit. The main problem is the high growth in expenditures. Reasons for this are: (1) the rising public sector wage bill (70 percent above 1997) despite low inflation, and (2) a very sharp growth in expenditures on health and state pensions, partly for demographic reasons and partly to satisfy past arrears.

3. The Politics

The coalition Government elected in early 2000 has made substantial progress in reversing the nationalist and authoritarian policies of the previous Croatian Democratic Union (HDZ) Government. In a remarkably decisive step for a six-party coalition, the Government and the new President moved very quickly to commit Croatia to cooperation with the International Criminal Tribunal for former Yugoslavia (ICTY) and to sever costly support for ethnic Croats in Bosnia that had destabilized Bosnian sovereignty and cost Croats millions of dollars annually. As a result, international isolation ended, bilateral donors and IFIs have come forward with substantial resources, and Croatia has joined the NATO Partnership for Peace and the World Trade Organization in 2000. Soon after the elections, the EU formed a European Union Task Force for integration of Croatia into Europe. A Stabilization and Association Agreement with the EU is expected to be signed in 2001.

Despite its parliamentary majority, the Government faces disparate pressures from its member parties and strong challenges in maintaining public support as it wrestles with redirecting economic policies. There are strong public expectations that employment and living standards will improve, but this is not the case so far and likely will not be during the coming year.

The new Government is largely inexperienced and is inundated with domestic and international demands for decisions or actions that put stress on a management system that is emerging and still weak. This is compounded by the need to consider the various positions of the coalition parties as well as a rigid second tier of old line bureaucrats that stifle change and reform. Consequently, both the introduction of policy change and constraints to governing are genuine challenges. The limited number and relative weakness of civil society organizations, combined with a lack of opportunity for public participation in policy-making, are factors limiting effective pressure on the Government to move forward with difficult reform measures.

The HDZ, divided and weakened, is unlikely to pose an effective parliamentary challenge to the Government, but it does dominate the leadership in local governments. Local elections are scheduled for April 2001. This, in turn, will have an impact on the Government decentralization process, which should start in earnest in 2001. Decentralization will involve changes in authorities, budget sharing and revenue generation. The Government is expected to introduce new legislation on local governance and finance in 2001, and may also reorganize the administrative divisions of local and regional geographic areas.

The HDZ and other parties allied with the more militant war veterans' associations oppose the Government's efforts to track down war criminals and hold senior officers responsible for the actions of their subordinates. Despite protests after a series of arrests and transfer of individuals to The Hague, it appears that the public as a whole continues to support such cooperation, which is a condition for most donor assistance, including that of the U.S. Perceptions of donor tolerance of Serbia's lack of cooperation with ICTY and harboring of Milosevic after his recent ouster, however, are highlighted often by the Croatian public as an uneven and unfair application of the ICTY process.

A major step forward was the amendment of the Constitution in November 2000 to reduce presidential power and bring greater balance among the three branches of Government. President Tudjman expanded the constitutional powers granted to the President through extra-legal means to the point of despotism, and President Mesic promised during his election campaign to reduce presidential powers. The amendments introduce constitutional guarantees in local self-government in compliance with standards set in the European Charter of Local Self-Government. They also broaden the human rights protection afforded to criminal defendants in accordance with the European Convention on Human Rights, and they assure constitutional protection of the freedom to establish political parties. However, there is a provision allowing political parties to be declared unconstitutional if they "undermine the democratic order or the integrity of the Republic of Croatia", an apparent authority to curb right-wing extremism, which is perceived as a serious threat. Although a number of positive changes were made, the Constitution still fails to fully meet European human rights standards or protect non-Croatian citizens, and limits the judiciary's independence and impartiality.

4. Civil Society and the Media

The Croatian Constitution guarantees freedom of assembly and association. Government reports that about 20,000 NGOs are registered, yet only about 1,000 are actually active. In 1997, a new Law on Associations placed severe restrictions on NGOs, giving the Government broad powers to block their formation, monitor and even suspend their activities through administrative procedures, often arbitrarily applied. Under the present Government, a new law has been introduced and vetted to an unprecedented extent with the public, including the NGO community. It would provide a much more supportive environment for NGOs, and is expected to be enacted before the end of 2000. The remaining legislative agenda for NGO development is provision for tax exemption, which is included in a new draft tax law in a limited form that does not include human rights or environmental organizations among those eligible. USAID has been a significant supporter of NGO strengthening in Croatia.

The Constitution also guarantees all workers the right to form or join trade unions. In practice, trade unions are generally independent. Croatia's labor movement includes five major confederations and several large unaffiliated unions. An estimated 70% of workers are union members. All workers have the right to strike with the exception of the armed forces, police, Government administration and public services. Collective bargaining is legal and freely practiced. Tripartite dialogue also is possible through the Economic and Social Council, in which representatives of

unions, Government and the employers association participate. Unions have a particularly critical role in representing workers in state-owned enterprises being privatized. USAID supports the strengthening of the trade union confederations and their constructive participation in policy debates affecting their interests.

Independent electronic and private media are permitted in Croatia, but they exist in the face of severe constraints. There are eleven television stations licensed, but the only alternative to state-owned Croatian Radio-Television (HRT) news is the USAID-supported independent television network. For independent stations, the cost of obtaining offshore programming results in limited access to such programs, which means in turn more limited viewership advertising revenues. The financial viability of most independent media is precarious.

Eighty-five percent of Croatia's population gets its news from television. According to independent surveys conducted by media marketing firms, approximately 60% of viewers within the broadcast area of the USAID-assisted Croatian Commercial Network (CCN) watch its independent news broadcast, while most are believed to watch state television news as well. This high level of viewership, hopefully, will gradually translate into increased advertising revenues for independent affiliate stations and create the necessary momentum for a sustainable alternative to state media.

Some newspapers state that more than 50% of their gross revenues are lost through taxes and distribution costs. Several daily and weekly newspapers offer a range of political views and are editorially independent. Newspapers are costly in Croatia, and only six percent of Croatian citizens regularly buy newspapers, although most purchases represent several readers.

E. Cross-Cutting Factors Influencing the Reform Process

A number of cross-cutting issues directly affect the process of development and reform envisaged in this Strategy. Since they affect overall program performance, these areas are identified and briefly discussed as part of the strategic overview. They represent both constraints and opportunities.

1. The Regional Context

As part of the former Yugoslavia, Croatia's industrial base and trade was, to a large degree, determined by the economic interests and actions of the central Belgrade Government, rather than by market forces or competitive advantage. While Bosnia and Slovenia remain important trading partners today, the Bosnian market has been greatly reduced by war and economic hardship, and Serbia has become almost non-existent as a market for Croatian exports – a situation now expected to change with the recent political changes in Serbia and the attendant economic change (lifting of sanctions, opening of trade).

Given its past links to the Austro-Hungarian Empire and to Roman, Venetian and Italian powers, Croatia maintains a strong European mindset and deeply resents Western tendencies to view the country as a Balkan monolith. Economically, Croatia has looked increasingly since independence toward Western Europe for both exports

and imports. Italy, Germany, Bosnia and Slovenia were the main destinations of exports in 1999. The majority of imports come from Germany, Italy, Russia and Slovenia. Croatia was accepted for membership in the World Trade Organization (WTO) in July 2000 and began negotiations toward a Stabilization and Association Agreement (SAA) with the EU in November, thus forging a closer relationship with Western Europe and the global marketplace.

Unfortunately, one of Croatia's main exports is brainpower, since it supplies considerable numbers of trained workers to EU countries. While this results in remittances and also provides those who return with valuable experience applicable to Croatia, there is danger of permanent loss of competitive advantage if perceived lack of opportunity at home drives young people to leave Croatia permanently. At present, this is a serious concern.

Not surprisingly, there has been a distinct separation from Serbia since independence and the Balkan war. Croatians are closely watching the actions of Western nations as Yugoslavia reemerges from the Milosevic years and begins competing for donor resources and investment capital. At the same time, Croatian businessmen have been quick to seek a renewal of trade links with Serbia.

Both the Dayton and Erdut agreements require the Croatian Government to permit families who fled war-affected areas to return to their original homes. The new Government has publicly pledged to support the opportunity for thousands of minority Serbs now in Bosnia-Herzegovina and Serbia to return and reintegrate into their home communities, and USAID provides vital support to this effort. Encouraged by the new policy, the number of returnees – both organized and spontaneous – has increased dramatically in 2000. Nonetheless, progress remains very slow on implementation of Government programs to facilitate return, and resistance remains strong in some localities.

The Stability Pact for Southeast Europe was created in June 1999, with 27 signatories, with the objective of achieving lasting peace, stability and prosperity in the region. This is to be accomplished by bringing about mature democratic political processes, adherence to the Helsinki Final Act, preserving diversity and protecting minorities, creating vibrant market economies, combating crime and corruption, and ensuring the safe and free return of refugees and displaced persons to their homes. This strategic plan for USAID/Croatia coincides closely with the principles of the Stability Pact. USAID supports Stability Pact objectives through both bilateral and regional funding and is a participant in task forces and tables along with the Embassy.

2. Conflict Vulnerability

Five years have passed since the Dayton and Erdut Agreements ended armed conflict in Croatia and the other states of the former Yugoslavia, and considerable progress has been made – particularly in Croatia – toward ensuring long-term peace and stability. Nonetheless, many Croatians who suffered directly in the conflict still bear fresh scars, painful memories and hostile feelings toward their former adversaries. Many also face ongoing hardships and difficulties in exercising their fundamental rights. It is quite unlikely that a fresh, armed conflict will erupt in Croatia, but serious political crisis and localized inter-ethnic violence are not

unthinkable if the remaining problems of war-affected populations are not adequately addressed. USAID has an important role to play in helping to bring about such remedies.

Following the conflicts in Croatia and throughout the region, approximately 340,000 Croatian Serbs became refugees in the Federal Republic of Yugoslavia (FRY) and Bosnia and Herzegovina (BiH), while 140,000 Bosnian Croats, mostly from Republika Srpska in BiH, wound up in Croatia. The Dayton Accords gave high priority to the return of all citizens to their own homes and communities, but under the Tudjman regime the Croatian Government failed to pursue this goal and placed a number of roadblocks in the way of Croatian Serbs who expressed a desire to return to their homes. Prospective returnees were unable to reclaim their property because the temporary occupants of their homes were encouraged to become permanent settlers. These temporary occupants were led to believe that by staying in this housing, they eventually would become legal owners by virtue of their long-term occupancy. Scarce reconstruction resources were disproportionately directed to areas populated by majority Croats at the expense of areas where ethnic Serbs were returning or had expressed a wish to return. Hostile incidents toward returnees, while not widespread, acted as a deterrent to return.

Policies on refugee return have been changed by the new Government, partially through legislative amendments that have declared returnees' rights to return and reclaim their homes to be paramount, and the Government has promised even-handedness in allocating funds for reconstruction. These changes clearly have increased the confidence of refugees, as evidenced by the increased flow of returns. According to UNHCR some 26,000 people have returned thus far in CY2000, either spontaneously or through organized channels. However, implementation of the new policies has lagged and, in many cases, has been obstructed by local officials who remain loyal to the HDZ party of President Tudjman. Property claims are acted upon at a glacial pace by local housing commissions, some of which are not functioning at all. Many majority-Serb villages still lack power, water, schools and access to other local services. War-affected areas suffer the highest rates of unemployment in the country, and thus most returnees to date are elderly pensioners rather than economically active younger families.

The potential for political crisis arising from these problems could be heightened by a small but highly vocal extremist element within the majority Croat population, particularly in some (but not all) war veterans' organizations and right-wing political parties. These groups are particularly unhappy about the new Government's cooperation with the International Criminal Tribunal for the former Yugoslavia (ICTY). A larger number of Croatians support the Government's policies, however.

USAID is addressing these problems through the programs funded under SO 3.1, Accelerated Return and Sustainable Reintegration of War-Affected Populations. These programs work in partnership with local governments whose leaders agree to meet conditions that embody the Dayton principles and objectives. They combine support for local infrastructure reconstruction with efforts to stimulate job creation and economic development, as well as advocacy for legal rights, inter-ethnic confidence building, community reconciliation, and facilitation of cross-border

returns with Bosnia. This year, these various kinds of assistance are being more closely integrated to maximize impact.

In addition, the Mission is exploring possible ways to help resolve property issues, including facilitating alternative housing solutions for Bosnian Croats who must vacate their temporary homes in favor of returning Serb owners, without undertaking direct construction of housing. (Housing construction is prohibited under the SEED Act.) These efforts are likely to focus on economic incentives to stimulate a more active private housing market through financial support to housing-related businesses, lenders and perhaps the war-affected groups themselves (both returnees and settlers) needing resources to find housing or repair their own homes.

3. Competitiveness

Croatia should, with its educated workforce, favorable geography and orientation toward European integration, be a powerful competitive force in international markets. For various reasons, at this time it is not. During the 1993-98 period, Croatia's export growth averaged only 4% annually -- less than all other CEE countries measured (not including Bosnia and Yugoslavia). Croatian consumers demonstrate with their feet that Croatia is not competitive when they regularly travel to Slovenia, Austria or Italy for routine shopping, including food.

The basic reason for Croatia's poor international competitiveness is its lack of the foundations for high productivity and competitive and vigorous internal markets. Croatia lags behind most other countries of Central and Eastern Europe in the private sector share of the economy (about 48%), and in percentage of the workforce engaged in non-farm self-employment (7%, compared with 11% on average for CEE countries) or the small and medium enterprise sector (6%, compared with a CEE average of 13%). In gross domestic investment, Croatia falls behind Hungary, the Czech Republic, Poland, Slovakia and Slovenia, leading only Romania, Bulgaria and Albania. The Heritage Foundation's Index of Economic Freedom places Croatia surprisingly behind all its CEE neighbors except Bosnia and Albania (again, Yugoslavia was not included).

Cardinal aspects of a competitive economy include: (1) competitive markets with sound and reasonable regulatory policies in place; (2) efficient markets in products, labor and capital; (3) well-defined property rights, effective and clear enforcement of contractual obligations, and an efficient system for resolving disputes; (4) effective public administration based on mechanisms and processes for good governance, and accountable open and transparent public institutions; and (5) efficient and sustainable social and physical infrastructure, including information technology.

Comparative advantage in the traditional sense -- focused on natural resources, climate and location -- enables exporters to enter the international market, but does not assure their survival or improve their competitive position. To change comparative advantage into competitive advantage, Croatia needs vigorous domestic competition and institutions that stimulate and facilitate the process of learning and innovation. Factors such as speed, flexibility, knowledge and information flow are essential for Croatia to establish a competitive edge in trade and exports. Croatia's relatively small size adds to the importance of its being competitive.

So far, Croatia has not demonstrated the ability to readily adapt to changes in the increasingly global economic environment. True privatization has lagged, a legal and regulatory environment that fosters change and innovation by individuals and private entities has not emerged, structural barriers to economic growth and business formation have not been removed, and lack of transparency remains the norm in governance and in economic transactions. On the positive side, Croatia is eager to join an increasingly competitive European Union and the new Government wants to bring Croatia into the global economy. As the country moves toward greater transparency, adopts modern information delivery systems, improves business management skills, creates a base of SMEs, and provides the necessary enabling environment for all this to happen, its productivity and competitive position is expected to significantly improve. The USAID Strategy seeks to advance these critical objectives.

4. Gender

Because of both economic and equity issues, gender affects program performance in all four Strategic Objectives, and its inclusion in strategic and activity planning will result in better targeted and more effective programs

“Gender” is not a euphemism for “women”. It means examining the constraints and opportunities for both men and women - particularly as they may differ. Including gender means assessing: how the problems of men and women may be different; how the impact of activities may differentially affect women and men; and how the contributions of men and women may contribute to results in different ways.

In the ten years following the period of socialism, when women had major roles in the workplace, Croatian society has revived its traditionally conservative stance. Even under socialism – and continuing today -- men have retained a dominance in most of the higher and well paid jobs, while women are in lower positions with less pay.

The former ruling HDZ party strongly supported traditional Croatian values of nationalism, patriotism, patriarchy and Catholicism. This system resolutely emphasized a traditional gender role, primarily with the underlying responsibility of women in society as homemaker and mother. These values appear to have had little effect on the demography and structure of the workforce, however, possibly because of the relatively short time they were in effect or the need of families to continue receiving two incomes. Despite the HDZ policy, the combination of out-migration, the impact of war and an unstable economy have resulted in fewer young people and an aging population. Croatia has been faced with a negative net birth rate over the past ten years.

Despite this situation, over the last decade Croatian women have become successful in organizing numerous civil society organizations. An initial gender assessment in early CY 2000 stated that women’s NGOs in Croatia are among the

strongest in the region. Many of them have been effective in providing humanitarian assistance, psycho-social services to victims of war, battered women and abused children, and working in human rights and peace groups. At the same time they have been successfully fighting against traditional values and stereotypes and advocating women's issues, reproductive rights and rights of refugees, displaced and minority groups. Also, women's NGOs have made major inroads in encouraging political participation of women and raising public awareness about violence against women, which has been on the increase since the war.

On the other hand, the Croatian male population and especially veterans have been heavily affected by the problems of post-traumatic stress disorder, which the previous Government had a tendency to neglect. Because of arms that remained after the war, violence has increased. Also, the country's serious economic problems and other political and social changes have affected Croatian women and men. A large number of adults have become unemployed and have experienced serious difficulties adjusting to the changes caused by transition. Additional problems are connected with the elderly population, both men and women.

While women's participation in politics was not encouraged in the past, there has been an increase from eight percent of women MPs in the previous Parliament to over 20% in the new Government elected in 2000. One of three deputy Prime Ministers and two ministers (tourism and health) are women. This achievement will serve as a starting point for more balanced gender politics in the future. The current Government has inherited a host of problems, and needs time and strength to better deal with gender issues. Even the Gender Equality Commission established during the previous Government still does not demonstrate full understanding and commitment of Government officials to improve gender relations through partnerships with women in NGOs, trade unions and businesses. Although women from civil society are committed and interested in gender issues, concrete actions can be expected only by a concerted effort. Gender issues also have been largely neglected in the formation of reintegration and economic restructuring policies.

This strategic plan will consciously address the need for increased gender balance in areas such as advocacy and other training, business development including access to credit, strengthening of civil society organizations, positive media exposure and participation in Government. To monitor change and differential impacts on men and women, all results indicators will be disaggregated by gender to the extent feasible.

5. Corruption

Corruption is a particular problem in transition countries where institutions of governance are weak, economic and political change are occurring rapidly, public officials are faced with responsibilities for which they have little or no training or experience, information about public and private activities is rarely available to the public, and nascent market economies are operating in a vacuum of non-transparent and insufficiently independent regulation. For such societies, the cost of corruption is high: both domestic and foreign investment are deterred, public revenues are lost and therefore unavailable to provide social benefits to those who need them, income

inequality grows as a privileged few capture disproportionate benefits unfairly, and confidence in democratic systems and market economics erodes among the populace.

In a survey of transition countries in Central and Eastern Europe and the former Soviet Union, the World Bank ranks Croatia in the mid-range with respect to corruption. While administrative corruption – the taking of bribes and other personal favors in exchange for favorable administrative actions – is believed to be relatively low in Croatia, “state capture” – that is, unfair and inappropriate influence on legislation and public policy exercised by special interests – is considered high. Transparency International’s worldwide index of corruption perception (based on sample surveys in each country) ranked Croatia 51st among 95 countries in 2000, a significant advance from the country’s 74th place ranking in 1999. It is likely, however, that this improvement was related primarily to the public’s new hopes for improved governance and integrity following the January-February election of a reform-oriented Government. Absent real evidence of change, it is possible that public perception of corruption will again slip to a lower level in Croatia.

As part of the preparation of this Strategy, USAID/Croatia carried out an initial assessment of corruption in Croatia and of opportunities to address the problem within the bilateral assistance program. Based on the team’s findings and recommendations, the Mission has decided to address corruption in two ways: by mainstreaming anti-corruption efforts throughout its portfolio, and by undertaking a focused effort to heighten citizen awareness of and demand for systems of accountability, transparency and good governance, while promoting better practices among public and private leaders. Both approaches will invite -- indeed require -- participation of a wide variety of partners including the wider USG community, our implementing partners, other donors and (most importantly) Croatian public and private counterparts.

The mainstreaming component will involve the identification of vulnerabilities, as well as reform needs and opportunities, within each SO and activity in USAID’s program and in other USG-supported initiatives. Among the ongoing elements of the USAID/Croatia program that will reduce corruption are the support for media and NGOs that can serve as integrity watchdogs; creation of legal frameworks that set fair and predictable rules for the business sector and increased transparency in the public sector; an independent and efficient judiciary at all levels; standards and requirements for corporate governance, accounting and financial disclosure in the private sector; and assistance to local governments in the provision of public services.

As a new initiative focused specifically on corruption, USAID will convene a U.S. Mission anti-corruption working group, as well as meetings with other donors and implementing partners, to kick off the Anti-Corruption Initiative. In addition, USAID will initiate a dialogue with key counterparts to signal our interest in this area and to receive their views on how we can best support their own new initiatives in this area. To have effective, enduring reforms that minimize corruption and to create sustainable improvements in public integrity, the Government will need to focus on changing systems, not just the exposure and punishment of past wrongdoers. The free flow of information, including access to Government, is an essential part of effective transparency, accountability and good governance. Experience from countries that

have undertaken strong anti-corruption campaigns indicates that real progress is likely to take a long time. The Mission expects that anti-corruption efforts will be a significant cross-cutting initiative throughout the period covered by this Strategic Plan.

6. Information and Communications Technology (ICT)

In the 21st century, modern ICT capacity is a fundamental component of economic competitiveness, productivity and growth. It is as important for the political system and local development as it is for basic economic growth.

The presence of an extensive national fiber-optic network with modern switching equipment gives Croatia one important prerequisite to a competitive advantage for wireless telephone and Internet service markets. This physical infrastructure, coupled with a depth of technically competent, highly educated labor, should place the country well to become an IT-based economy and to compete internationally in “new economy” fields. However, for a variety of reasons this potential has yet to be realized.

At present, there are only four Internet service providers – compared with more than 50 in Slovenia and over 160 in Bulgaria -- and only 100,000 Internet service subscribers in Croatia. The local software and computer services industry is small, and most of the IT-related businesses in the country are retail equipment resellers. Computerization has not progressed significantly in the business field or in Government; most uses in these sectors are simple word processing and accounting functions. Over half of the country’s Internet use is related to schools and universities. Wireless telephone use, on the other hand, is extensive in Croatia.

The chief constraints to development of an IT economy in Croatia are the monopoly control of licensing and access to infrastructure by the state telecommunications company, Croatia Telecom (HT); lack of a genuinely independent regulatory body; high license fees; and an unfriendly private business environment. A series of IT-specific laws needs to be enacted in areas such as digital signature, electronic payments and funds transfers, privacy, consumer protection and computer crime in order to attract greater electronic business use of the Internet. These are essential for global integration and market competitiveness. More fundamentally, creating a sound environment for small and medium enterprise development, innovation and improved management skills will foster IT development along with other knowledge-based businesses in Croatia.

7. Environment and Biological Diversity

Croatia faces many difficult environmental issues, some a result of the conflict, others a result of socialist industrial policy and development, and still others a result of ineffective Government institutions and policies and lack of public attention to these issues during the post-independence period. The Government is finalizing a World Bank-funded National Environmental Action Plan (NEAP) that identifies a number of environmental issues including inadequate management of solid and hazardous waste, inadequate institutional systems for environmental management, fresh-water and coastal pollution from industrial and municipal

effluents, air pollution, loss of forest cover, and environmental impacts of uncontrolled economic development.

In the early 1990s, environmental regulation was scattered throughout a number of ministries with the majority of environmental responsibilities falling on the Ministry of Physical Planning, Construction and Housing. Many new environmental laws and regulations were put in place in the middle 1990s. They were intended to allow the country to manage its solid and hazardous waste, air and water pollution issues, enforce environmental impact assessment standards, and other activities. With the beginning of the new Government in 2000, environment was raised to the Cabinet level with establishment of the Ministry of Environmental Protection and Physical Planning. Nevertheless, there is still a lack of institutional capacity to manage environmental issues in the country. The deficiencies revolve around four areas: information systems, financing, integrated planning, and education and public awareness.

While there are regulations in place requiring proper disposal of solid and hazardous wastes, they are not often enforced and there are few treatment or disposal facilities in the country. The primary forms of treatment and disposal are landfills and incinerators, but there are few licensed landfills or incinerators and most solid and hazardous waste does not appear to be managed appropriately.

Air pollution seems to be of great concern in Croatia. Mobile-source air pollution is a problem in the more developed areas of the country, particularly in the city of Zagreb. Stationary-source pollution consists of emissions from power plants, metal processing industries and other heavy industries. While industrial production has fallen sharply in the last decade, the remaining industries generate acid rain that has had a negative impact on the forests in the country. (Acid rain also appears to be a trans-boundary problem and in fact as much as 60 percent of it may originate outside Croatia's border.) Pollutants that arise from stationary sources include sulfur compounds (SO_x) and nitrogen compounds (NO_x), which are significant contributors to acid rain. Other compounds of concern include fluorides, hydrogen sulfide, and mercaptans.

Water pollution also is of great concern in the country, although drinking water quality is reported to be generally good. The River Sava is reported to be the most polluted river in the country. The main sources of pollution reportedly are chemical plants. Little detailed information is available on the effluents from these plants. There also is reportedly little or no municipal wastewater treatment capacity in most of the urban areas of Croatia. This leads to untreated wastewater discharges into nearby surface waters. Continued discharge is likely to have significant impacts and could begin to affect drinking water quality because of discharges to rivers and lakes, and potential damage to Croatia's essential tourism industry in coastal areas of the Adriatic Sea.

Recent figures indicate that 38 percent of the country is forested. The 1991 Forest Law set aside 79 percent of all forest in the country for management by the parastatal "Croatian Forests". Much of the wood cut in the country appears to be used for fuel, although Croatia has also had a significant wood products industry. Cutting levels are set such that the forests are able to regenerate, and poaching does

not appear to be a significant problem. Trans-boundary and locally-generated acid rain appears to be the largest threat to forest resources.

There is relatively little data on biodiversity. It is likely that if forest cover is being decreased as a result of acid rain, then biodiversity may be decreasing as a result of both acid rain and decreasing forest cover. There also is some discussion in other sources of over-fertilization in some of the agricultural parts of the country leading to problems in soil chemistry.

Conservation of biodiversity will be a particular challenge as Croatia's economy grows and decentralized Governmental responsibilities are transferred to the local level. Croatia is endowed with richer biodiversity than most European and Mediterranean countries, including unique habitats and hundreds of endemic, rare and endangered species. However, too little is known about these biological resources to provide the most basic information required for planning and monitoring impacts of development activities, and human resources are too few to meet the short-term need for better information.

Government agencies responsible for protecting and managing biological resources are understaffed, and in many cases lack the appropriate training and scientific expertise. The Strategy and Action Plan for the Protection of Biological and Landscape Diversity of the Republic of Croatia, adopted in 1999, outlines an ambitious national biodiversity agenda, and new obligations under global and regional environmental agreements, to which Croatia is or soon will be a signatory, will additionally challenge environment infrastructure. While there remain serious questions about how these obligations will be implemented, there is a general understanding of the problems, and a collective will and desire to press ahead and do all that can be done.

From an endangered species perspective, project related impact assessments and mitigation have been largely inadequate and post project monitoring is mostly non-existent. Scientists report that species have gone extinct as a direct result of development activities over the past ten years and many others are believed to be near extinction, but no one knows for sure how many species, where or exactly why. Dams, draining wetlands and diversion projects change the water regime, while landfills, wastewater treatment, agricultural and industrial pollution have accumulative negative impacts on species, sometime far from the source of pollution. Ecosystem and landscape scale research, planning and management of natural resources are particularly weak, yet the sorts of problems facing biodiversity in Croatia require a systematic approach to managing large landscapes impacted by multiple projects.

Water, including groundwater is a critical factor for much of Croatia's most unique and endangered habitats and species. The karst (limestone) region that dominates west and south Croatia, including the coastal islands, harbors biodiversity of global significance, being exceptionally rich in rare, endemic species, including riverine and cave dwelling species that are particularly vulnerable to extinction as a result of small changes to their environment. Water moves through karst like a sieve, carrying with it the nutrients need to sustain the diverse subterranean species, and the pollution that threatens their existence.

Responsibility for natural resources planning and management is shared among national, county and local government, with plans to move more responsibility to county and local agencies, which for the most part do not yet exist, but should be created over the next two years. There is pressure for county and local land-use plans to be developed under short timelines, and no assurance that proper consideration will be given to protecting biological resources, particularly from cumulative impacts across municipalities and counties.

There are eight National Parks and ten Nature Parks under the jurisdiction of the national Government and hundreds of additional protected natural areas that are the responsibility of local governments. Management of these priority sites is adequate in a few cases, while others, including six areas formally recognized under international agreements, are sometimes managed more as profit-generating resorts without adequate public education or impact protection, or for timber production than for protection of their rare biological features, and most parks are not managed at all. State forests are managed with little or no consideration for protection of biological diversity and natural areas under the jurisdiction of local government are mostly unprotected.

New laws on nature protection and the environment, due to be approved in 2001, provide for many changes that, if implemented, will improve the outlook for biodiversity in Croatia. The new Government is already implementing some important changes, including a more responsive and open process for environmental impact assessment. Implementation of the law will require substantial cooperation between the Ministry of Environment and Physical Planning, other ministries and agencies (e.g., forest and agriculture, water, and energy), state institutions (e.g., state forests) and local agencies. Communication and coordination among national agencies is problematic at best, and the problems will likely be amplified as the municipalities and counties get more involved. The rash of forest fires in the past five years exemplifies the problems of communication, coordination and assignment of responsibilities for who will fight fires (short-term solution) and who will manage lands to reduce the high fuel loads that have made fires so severe in recent years (long-term management).

The environmental NGO community has grown in recent years and has demonstrated its ability to engage public participation in environmental decision-making and to assist with planning and management of protected areas. Strengthening the environmental NGOs can further encourage public participation, transparency of Government and can build vital technical capacity to address the problems of biodiversity conservation.

This Strategic Plan will address environmental and biodiversity issues by incorporating environmental factors in project planning and monitoring, particularly in the karst region, which dominates that part of the country where the USAID anticipates strengthening the tourism industry, as well as the area where USAID programs support refugee return. Limited technical assistance and training to emerging environmental programs in county and local governments and NGOs, perhaps through the new NGO community grants program and the local government reform program, can significantly improve biodiversity and environmental

management. A successful national program must resolve the problems of inter-agency communication and coordination regarding biodiversity management, which should be addressed through cooperation among donors and with all stakeholders in Croatia. USAID may be able to play a small but supportive role in such an effort.

F. Strategic Priorities

1. The Goal

USAID's overarching goal for Croatia in this strategic planning period is the development of a fully democratic society and productive market economy that together serve as a cornerstone for prosperity and stability in the region. There are four preconditions for Croatia to achieve this goal, each of which corresponds to one of USAID/Croatia's Strategic Objectives. The first is the development of conditions that foster competition and constantly increasing productivity, innovation and job creation in a vigorous private-sector led economy. The second, no less important, is the building of a transparent, accountable and effective political system at central, regional and local levels that is responsive to citizen needs and fundamental principles of democracy and human rights. Third is an application of those principles to the return and sustainable reintegration of all refugees and displaced persons who wish to reclaim their original homes and resume their productive lives in Croatia, in accordance with the Dayton and Erdut Agreements. Fourth and final is the mitigation of adverse social impacts of these multiple changes, in order to improve living conditions and sustain the political will so necessary to the transition process.

2. Focus

Each Strategic Objective is believed to be achievable within the planning period considering the projected resources available and USAID's capacity to attain necessary results.

SO 1.3, Growth of a Dynamic and Competitive Private Sector, is the first and (in resource terms) most significant new strategic priority in the Mission's portfolio. Its focus will be on promoting competitiveness and private enterprise development, particularly small and medium enterprises (SMEs). Assistance provided to privatization of state-owned assets and to fiscal reform will encourage a competitive market environment and reduce the current public-sector dominance of the economy.

SO 2.1, More Effective Citizen Participation and Improved Governance, will focus most of its resources and attention on development of good governance at all levels. A particularly important dimension is support to increasing local government capacity, as many public functions and authorities are expected to be devolved to the local level. Development of a strong civil society and independent media will remain central to this objective.

SO 3.1, Accelerated Return and Sustainable Reintegration of War-Affected Populations, is a continuing objective that can be measured by easily quantified results. However, under this Strategy, the emphasis will shift toward a comprehensive community-based approach that will bring a critical mass of assistance

with infrastructure reconstruction, economic revitalization efforts, community-building and legal aid in communities that welcome and contribute toward the return of minority citizens to their towns and their homes. A second important change will be the increased use of market mechanisms and economic incentives to support the return and reintegration process. This objective will be phased out beginning in the third year of the planning period if conditions warrant.

SO 3.4, Mitigation of Adverse Social Conditions and Trends, is a new objective that relates closely to the other three. Undertaken as a result of increased resources made available to USAID/Croatia recently by the Congress, this SO will be modest in terms of resources but will leverage change and investment in the social transition in important ways. Addressing the central need for job creation, the objective will support a tripartite initiative of Government, employers and workers to find fair and effective solutions to unemployment problems and other labor-related issues. Reform of labor regulations appears to be a particular need. Pension reform will be a second focus. Smaller initiatives will address issues of health, education, and the special problems of vulnerable groups, particularly youth and minorities. In the latter part of the planning period, this objective may assume responsibility for the final stages of work with minorities and returning refugees. This SO will be led by the Program Office.

STRATEGIC FRAMEWORK



3. Linkages Across Objectives

Ultimate accomplishment of our strategic goal depends upon the effective synergy among all four strategic objectives. For example, increasing employment through creation of a vibrant private sector is necessary to support the long-term sustainability of democracy. Economic growth impacts on day-to-day life of citizens and will have a special effect on communities where people return and reintegrate into their societies. The absence of job opportunities in these areas could result in ethnic cleavages and the democratic process could backslide. Broad-based growth, equity and employment are essential for democracy to prosper.

Conversely, good governance and a strong civil society are critical for economic growth to occur. Establishing laws, policies and regulations which are necessary for increased investment and business growth will not have the intended impact if courts and regulatory bodies do not have the institutional capacity to ensure they are fairly, promptly and uniformly adjudicated and enforced. The ability of non-governmental and business associations to advocate issues will have a direct impact on economic change, and will provide a watchdog role for integrity and anti-corruption in Government institutions.

A cross-cutting initiative on anti-corruption will address a central issue that has impact on all four Strategic Objectives. It will be managed by the Program Office in close coordination with all SO Teams.

4. Basic Assumptions for Strategic Success

A number of conditions beyond the sphere of USAID's control must be met or maintained in order to achieve successful results in this Strategy. These are necessary for an appropriate political and economic environment that supports attainment of all Strategic Objectives. Lower-level assumptions are identified in Part II in the discussion of individual SOs. Strategy-wide assumptions are:

- Peace will prevail in the states of the former Yugoslavia, with no conflicts or outbreaks of hostilities in the region, and democratic transition will advance in post-Milosevic Serbia.
- Transition in the political process and the economy will continue through normal processes inherent in open societies and markets.
- The governing coalition in Croatia will remain intact or, if changed, will continue its commitment to democracy, human rights and a market-oriented economy.
- No major external economic shocks will occur.
- Croatia will sign a Stabilization and Association Agreement with the European Union, thereby opening its economy and Government to the new opportunities, resources and international obligations that come with candidacy for EU accession.

- The Government will maintain its policy to comply with the Dayton and Erdut agreements and its commitment to cooperate with the International War Crimes Tribunal.

5. Sustainability

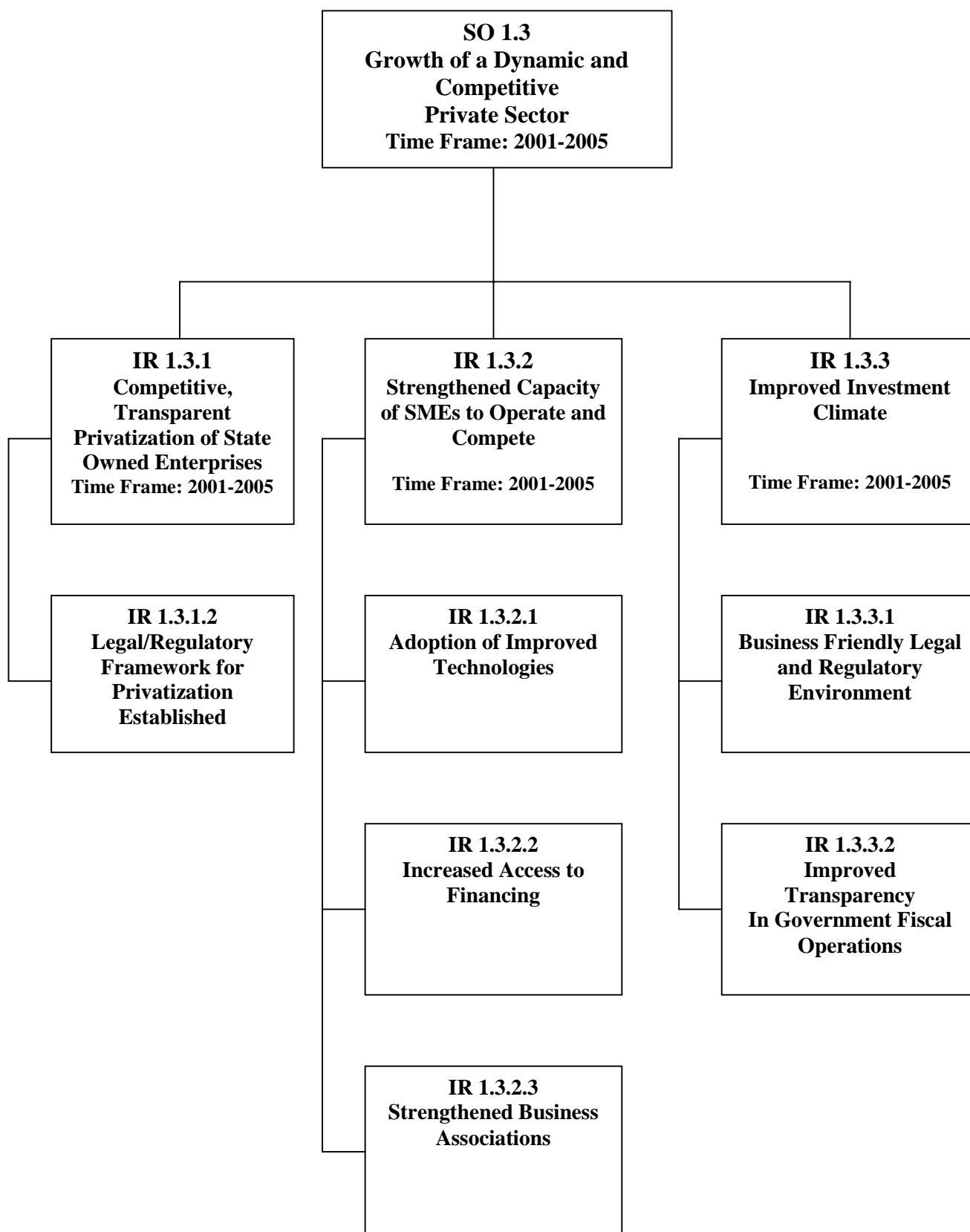
Each SO contains elements that build and strengthen institutions -- national and local governments, business associations, private enterprises, and civil society organizations. The programs and changes achieved through implementation of this Strategy are aimed at providing lasting results from local commitment to progress and success. Sustainable institutions at all levels will establish a foundation for stable, democratic, competitive political and economic systems that result in U.S. foreign policy interests being met and Croatia becoming a graduate of USAID assistance.

During the last year of this strategic planning period, a careful assessment will be conducted to determine the extent to which the goal is being met, and to establish measurable criteria for Croatia's graduation from USAID assistance.

G. Customers and Partners

In mid-2000, about five months after the new Government was elected, a USAID partner and local polling firm conducted a series of focus groups in six Croatian cities to determine people's expectations, insights and attitudes about the new Government and the issues that are most critical to their futures. Fourteen focus groups were selected by socio-demographic criteria representing a cross-section of Croatian society by location, gender and age. As representative of the ultimate customers of the USAID program, their views were extremely helpful in setting the direction and confirming strategic areas of importance. For example, unemployment, the lack of effective rule of law, the "cost" of Euro-Atlantic integration, and corruption in privatization were cited as central issues that need to be given priority attention. Customer views derived from the focus group exercise are being addressed in the Strategy.

USAID views its role as a highly collaborative partner -- sometimes in the leadership position, sometimes not -- with host country counterparts, bilateral and multilateral donor agencies, other USG agencies and the Country Team. USAID is in the process of strengthening and broadening membership in its own Strategic Objective teams to deepen linkages to partners and further increase complementarities with other assistance and investment partners. We cannot achieve our strategic goal alone, but we believe we have a critical, perhaps decisive, contribution to make, and we are enthusiastic about our challenge.



PART II: STRATEGIC PLAN

STRATEGIC OBJECTIVE 1.3: GROWTH OF A DYNAMIC AND COMPETITIVE PRIVATE SECTOR

A. Statement of Strategic Objective

The political changes of the past year were driven substantially by popular demand for improved economic conditions. Croatia has many strengths on which to build a sound economy, yet significant obstacles have limited economic growth, job creation and investment since independence. With war and an autocratic regime now behind it, Croatia is in a position to advance significant structural reform and take its place as a player in global, European and regional markets. Croatia must rapidly reduce the role of the public sector in the economy and put into place the laws, policies and institutions required for emergence of a strong market economy dominated by a dynamic and competitive private sector. If successful, Croatia may be poised to provide a regional model for sustained economic growth and development.

International organizations are prepared to welcome and support Croatia's economic transition, as evidenced by the country's July 2000 accession to the WTO and the November 2000 start of negotiations toward EU accession. These two achievements will immediately improve Croatia's access to key markets and increased donor resources. Croatia also enjoys a well-educated workforce, reasonably well-developed infrastructure, a promising tourism sector, and a location both on the doorstep of Europe and adjacent to the growing post-conflict markets in the Balkans.

Competitiveness will be the overarching theme of SO 1.3. It is the central premise of this program that international competitiveness can best be advanced by developing a vigorous, competitive economy at home. Accelerated growth of competitive private enterprises is thus essential if Croatia is to increase and sustain economic output, increase Government revenues, compete in the international marketplace, create jobs and reduce unemployment.

Under SO 1.3, USAID will support macroeconomic and structural reforms to improve the enabling environment for private sector growth. The privatization process will be accelerated in order to move those productive assets remaining in state hands into the private sector, and to stop the wasteful flow of scarce public resources into unproductive enterprises. At the same time, the work in SO 1.3 will pursue enterprise-level interventions to help businesses acquire the skills, tools and services needed for them to compete in increasingly competitive local, regional and global markets. Firm-level assistance will focus on small and medium size enterprises, especially in those sectors in which Croatia is most likely to be in the strongest position to compete (e.g. tourism, agricultural processing and information technology).

B. Problem Analysis

Increased levels of private investment from both foreign and domestic sources are vital in order to create rapid and sustained economic growth in Croatia. In order to attract such investment the GOC needs to privatize remaining state-owned

enterprises; improve Croatia's overall investment climate; and rectify the many impediments to establishing and operating a business -- especially in the small and medium enterprise sector. With current high levels of unemployment only expected to rise to higher levels in the near term as enterprise restructuring moves forward, the private sector, especially small and medium enterprises, must be the dynamic engine of job creation.

The GOC plans to move forward with an aggressive privatization program over the next several years, but appears to lack the institutional capacity to carry out the plan quickly and effectively. Political pressures to limit job losses and to move quickly to generate sales revenues may also hamper the program, by imposing unreasonable conditions on buyers or leading to negotiated sales in lieu of wide advertisement, maximum competition and transparency. The Croatian Privatization Fund (CPF), charged with carrying out the privatization of the bulk of the state-owned assets, has been more of an asset management agency than a privatization agency. Due to interagency bureaucratic struggles, transfer and consolidation under the Fund of assets for privatization from the other state agencies has not been completed as scheduled and mandated by law. The Fund has virtually no experience in the multiple and complex sales processes that are required.

The risks inherent in a poorly executed privatization process are huge. The public will quickly see anything less than a fully open and transparent process as a return to the "crony capitalism" privatization process that was carried out in the mid-1990s. Many of those sales transactions were with well-connected insiders of the former HDZ Government. The buyers in many cases made no investments in the enterprises they acquired, instead stripping them of assets and spiriting capital abroad, and many of those companies are now insolvent. Many of the newly privatized firms also received commercial bank loans based on political favoritism, and their failure to repay contributed to the collapse of several banks. The history of that round of privatization along with the disastrous results has been widely publicized and discussed, and any perception of a repetition might well result in a critical loss of public support for the entire reform process.

Although Croatia appears to have many of the elements of an investor-friendly legal and regulatory structure in place, vitally important aspects have yet to be addressed. Timely and impartial enforcement of contracts and settlement of commercial disputes cannot be ensured in an underdeveloped and inefficient court system. Bankruptcy proceedings are especially problematic and time consuming. The legal framework for bankruptcy is not complete, and judges and court personnel are ill-trained to move cases through the process. Security interests in real property and other assets cannot be ensured due to underdeveloped or nonexistent registry systems. Government fiscal policies, with bloated and uncontrolled expenditures leading to deficits and arrearages, create uncertainties for investors who fear inflation and higher interest rates.

The poor policy environment for business development is reflected in the lack of an active and dynamic SME sector. The many impediments to establishing and operating a business are magnified when shouldered by a small business owner facing an indifferent bureaucracy. Access to financing is a serious problem for SMEs. The commercial banking sector, although relatively healthy under foreign ownership in

many cases and currently highly liquid, views SME lending as high in risk and unattractive. The lack of a developed credit culture with negative consequences for non-repayment is clearly part of the problem. The banks are still recovering from the large portfolios of bad loans to the SME sector from the mid-1990s, and are not eager to extend new loans. The result is that even the various GOC and foreign donor-assisted lending programs carried out through the commercial banks are under-utilized.

The difficulties faced by SMEs in securing financing is to a great extent a reflection of their inability to present coherent business plans for analysis by potential lenders. Although Croatia has a large pool of highly skilled workers, there is a critical lack of the business management skills necessary to be competitive. Enterprise owners may well have good ideas, but they lack the financial analysis or business planning skills necessary to bring those ideas to fruition. With high unemployment rates, there is significant "brain drain" of some of the best of the labor force to higher paying jobs in Western Europe and the United States. Those that remain lack a culture of entrepreneurship.

Overall labor costs in Croatia are among the highest in Southeastern Europe, sharply reducing its attractiveness to investors unconstrained by borders. High labor costs are to a great extent due to current GOC labor and welfare policies, which create impediments to job creation and contribute to structural unemployment. These policies tend to create a "culture of employment" that emphasizes inputs, offers few incentives to use human resources efficiently, and fails to provide for quality control. Such policies include direct disincentives to hire and retain workers, in the forms of labor code regulations, non-wage tariffs contributing to high labor costs, and payroll taxes linked to highly inefficient social benefit programs imposed by the state that would be better left to the discretion of employers.

The Croatian labor code has features that reduce flexibility and mobility within and across skill paths, entitlements that essentially come at the expense of higher earning power, and few incentives to focus on productivity and competitive skill building. In extreme cases, policies create perverse incentives for able-bodied members of the workforce either to remain on public assistance or to engage in the underground economy. The state tries to absorb laid off workers through public administration employment, sets public-sector wages artificially high, and maintains social expenditure levels that are unsustainable. Unfortunately, labor and social policies are among the most politically charged and contentious among the six parties of the ruling coalition, and the issues identified here are seen as perhaps the most thorny this Government will face. To its credit, the coalition Government has undertaken a tripartite dialogue with labor unions and the leading employers' association aimed at agreement on a "social pact" that would include a three-year wage agreement in exchange for a significant worker voice in economic and privatization policy.

C. Results Framework

1. Causal Linkages

Three Intermediate Results have been identified as necessary to achieve the overarching Strategic Objective of the growth of a dynamic and competitive private sector. These include: (1) Competitive, Transparent Privatization of State-Owned Enterprises; (2) Strengthened Capacity of SMEs to Operate and Compete; and (3) Improved Investment Climate. The results framework diagram identifies six lower level IRs which support these three IRs.

IR 1.3.1: Competitive, Transparent Privatization of State-Owned Enterprises

The Croatian economy remains saddled with the remains of the old economy in the form of a number of large, inefficient and nonproductive state-owned enterprises. Privatization and restructuring of many of these entities would result in the productive rebirth of core business and the spin-offs of smaller viable enterprises. In other cases, valuable assets that could be put to productive use for private sector development are locked up in the shells of insolvent companies, which need to be bankrupted or liquidated. Resolution of these remaining enterprises will allow elimination of the high levels of state subsidies, helping to resolve the GOC's fiscal deficits and reduce the need for burdensome taxes. The state-owned electric utility company needs to be restructured and privatized to rationalize employment and bring much-needed investment capital to the sector in order that it can compete in regional power markets.

IR 1.3.2: Strengthened Capacity of SMEs to Operate and Compete

As privatization of the remaining state owned enterprises moves forward and a fundamental restructuring of the many troubled private sector enterprises takes place, a vibrant small and medium enterprise sector will be the engine of growth for job creation and the overall economy. In order to play this leading role, the SME sector requires the creation and articulation of a clear national public policy supporting SME development. Associations representing business interests must be strengthened to provide a voice to Government to advocate for the necessary changes in the investment climate and to provide support services to their memberships. Entrepreneurs trained in modern management techniques in marketing, financial analysis, and business planning will be better equipped to compete in internal and external markets. A deepened financial services sector providing a wider array of banking and non-banking financial intermediation services will be better prepared to serve these new and expanding SMEs.

IR 1.3.3: Improved Investment Climate

Significant positive changes have taken place in the legal and regulatory framework over the last ten years, but significant work remains to be done to create a truly business-friendly climate for investors. The most urgent needs are in the judicial sector, where the certainty of timely and impartial judicial enforcement of contracts will improve investor confidence. Improving the ability of creditors to secure and, if necessary, levy on their security interests in real and moveable property would help

mobilize credit to finance private sector expansion and productivity improvement. Sound GOC budget and fiscal policies would avoid undue deficit spending or the buildup of budgetary arrears, helping to alleviate investor concerns about overall economic stability.

An overarching concern for potential investors in a transitional economy is corruption, and clearly inappropriate rent-seeking by Government officials is an aspect of any inefficient public sector system. All USAID-assisted programs in this area will emphasize the creation of systems that maximize transparency and accountability.

2. Critical Assumptions

- The Government remains stable with a continuing commitment to economic reform
- The GOC and USAID development partners implement currently envisioned programs in critical reform areas
- The GOC continues on its path toward EU accession, and signs a Stabilization and Association agreement in the near future
- There are no large external economic shocks

D. Progress to Date

In the years beginning from the assistance program in 1993 until the recent changes in the Croatian Government in early 2000, USAID assistance was focused almost exclusively on the return and reintegration of war-affected populations and on democracy building. Until the present, programs to support economic growth-- except for some small activities in the financial sector-- were almost exclusively limited to those which promoted job creation in the war-affected areas to promote refugee returns. The progress to date of those activities is reported under SO 3.1. Although several short-term activities to promote economic reform began in the last six months, the portfolio of new longer-term interventions to achieve SO 1.3 is still under development within the overall framework of this Strategy.

In the financial sector, a program of bank supervision assistance to the National Bank of Croatia (NBC) was reactivated recently after being frozen in 1997, as an expression of USG concern over political issues under the prior regime. Prior to program suspension, good progress had been made toward increasing the capacity of the National Bank of Croatia to supervise individual commercial banks based on risk. With USAID assistance, the legal and regulatory framework was improved, providing the central bank with adequate authority to enforce prudential laws and regulations. In addition, the on-site and off-site supervision capacity of National Bank staff was strengthened through intensive training to ensure they had the necessary skills to provide oversight of the commercial banking sector.

E. Program Approaches

Over the five-year horizon of the strategic plan, USAID will develop and implement programs, which will move decisively to create an enabling environment for overall economic growth while providing more direct assistance to the developing private sector. USAID will support and build on the conditionality of its international development partners -- especially the World Bank and the IMF-- along with the requirements of EU accession, to keep Croatia on the path to economic reform. Focus will increasingly shift to ensuring that the people-level benefits of a more open market economy, especially in the form of rising employment and incomes, are enjoyed by greater numbers of Croatians.

USAID's assistance to the Croatian Privatization Fund will seek to build the institutional capacity of the Fund to enable it to carry out the GOC's plans for an aggressive program of asset disposition in a fully transparent and competitive manner. Plans for asset disposition include international tendering for the most attractive properties; sales of packages of GOC-owned residual shares of other enterprises in the stock market; restructuring in bankruptcy those enterprises with some hope of recovery; and outright liquidation of the most troubled enterprises. The Fund's request for USAID assistance emphasizes marketing and planning, valuation, ethics policy design and implementation, and accounting and information systems. Results of this assistance will include timely divestiture of state assets and increased integrity of the privatization process.

USAID has provided a full-time resident economic policy advisor to the Deputy Prime Minister. From his office next to the DPM's, the advisor has developed a close working relationship with the DPM. This relationship provides the DPM with market-oriented counsel on a wide range of economic policy matters, and facilitates closer communications among the DPM, the Embassy and the Mission on issues of mutual concern in the economic arena. As a result, the DPM should be able to strengthen economic policy coordination within the Government.

Under the recently-initiated fiscal reform program, technical assistance is being provided to the Ministry of Finance in the areas of integrated financial management and fiscal decentralization. Supporting the Ministry's implementation of the integrated financial management system will be a joint effort by USAID and the U.S. Department of the Treasury, with two Treasury advisors taking the lead on the budget and tax functions of the system and USAID focusing on the unified treasury and accounting functions of the system. Following successful start-up of the new systems, USAID will assist in the introduction of reforms aimed at better expenditure control and accountability.

USAID also will support fiscal decentralization linked to expected legislation on local self-government and local government finance. This work will involve both the Ministry of Finance and the Ministry of Justice, with the goal of reforming intergovernmental fiscal relations to allow greater local choice for services to be provided to the citizenry, along with greater local authority and responsibility for funding those services. This work will be carried out in close collaboration with the Local Government Reform Program under SO 2.1. USAID also may provide

leadership in other areas such as tax administration and extra-budgetary funds. The ultimate goal of the fiscal reform effort is to help the Government improve control of public revenues and expenditures, leading to a reduced budget deficit and better management of public finance.

Some of the most serious obstacles to the growth of private enterprises lie in the difficulties they face in settling commercial disputes, enforcing contracts and property rights, registering as companies and securing financial transactions. Most of these functions reside in the Croatian court system, and are generally viewed as seriously dysfunctional. Litigation in the commercial courts takes years to resolve, and the resulting backlog of cases threatens to grow worse as economic activity and bankruptcies increase in volume.

USAID has already provided short-term assistance aimed at improving operations in the court-based land registry of Zagreb, and has offered information and advice on establishment of a registry of secured transactions. Longer-term USAID assistance in commercial law reform is being designed collaboratively with the World Bank, and is expected to focus on land and company registries, establishment of a collateral registry, alternative dispute resolution and improvement of caseload management and court administrative systems in the commercial courts. Expected results include a reduction in case backlog and litigation time, as well as increased support to private enterprises through increased access to secured credit, faster and easier real property transactions, and greater use of non-judicial alternatives to litigation for dispute resolution. Improvements in the commercial court systems should also contribute significantly to an improved investment climate and increased protection against corruption.

Support to the small and medium enterprise sector will be a significant new program area starting in FY 2001. Although Croatia has many very small businesses with fewer than ten employees, the economy lacks a robust business sector of slightly larger firms (i.e., those with 10-200 employees). Employment in the SME sector in Croatia is only half as great as the Central and Eastern European average. Increased productivity and competitiveness will be the watchword of USAID's Strategy for enlarging and strengthening the SME sector. To address key problems impeding small/medium business development, USAID will take a "wholesale" approach, seeking to strengthen indigenous capacity to provide business consulting services. To raise the confidence of lenders now reluctant to provide credit to SMEs because of past poor repayment records, USAID will support efforts to develop a private credit reporting system. And to boost the international competitiveness of the country's most promising business clusters -- most probably including tourism, information technology and agribusiness -- USAID will work with business groups to develop competitive strategies and will foster public-private dialogue aimed at improving the overall competitiveness of Croatian business through policy change (including lowering of corporate tax rates) and other measures to boost productivity and innovation.

In the energy sector, USAID has begun working with the Ministry of Economy and with HEP, the national electric power utility, on analysis of issues relating to the legal unbundling, restructuring, and eventual privatization of the utility. Further advice has been requested on new energy legislation expected to be

introduced in the parliament before the end of CY2000. In 2001, USAID may assist with creation and start-up of an independent regulatory agency, and the development of new structures and rules needed to establish a fully competitive power market. These bilateral efforts would support USAID's regional energy assistance provided under the Stability Pact, which is focused on transmission planning, the formation of a regional transmission working group and an integrated power grid in Southeast Europe that will ultimately bring the benefits of expanded regional electricity trade to the region.

F. Development Partners

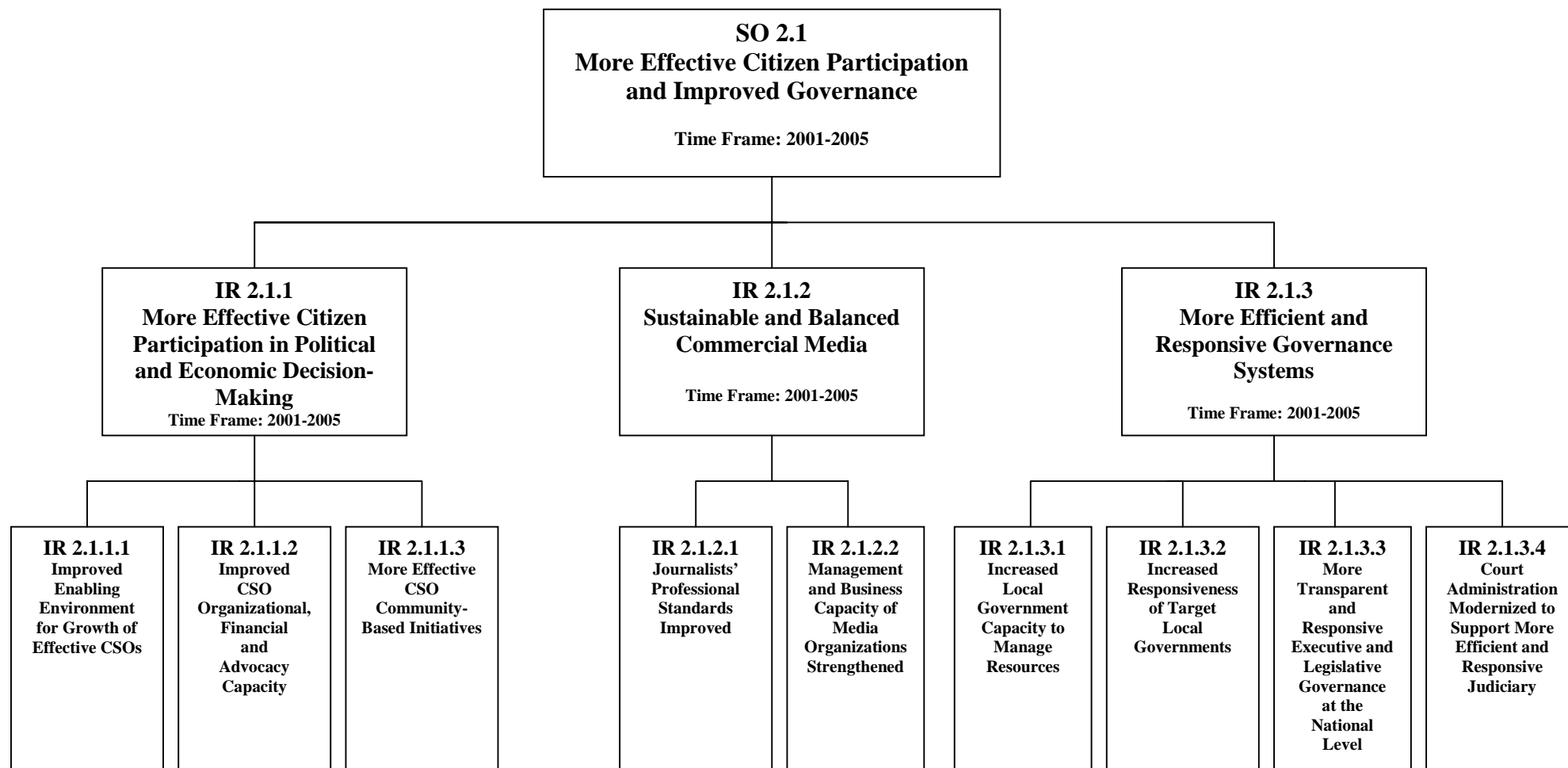
The USAID program is being developed in close cooperation with its development partners. Through continuous consultation, it is assured that the program builds on the strengths of each of the other donor organizations. The various aspects of the fiscal reform program were developed specifically to assist the GOC in meeting International Monetary Fund goals to improve GOC budgetary and expenditure controls in the Ministry of Finance. USAID-funded experts also have been provided to lead various sectoral reviews in the ongoing World Bank Public Expenditure Review.

As described above, the commercial law assistance program will dovetail with World Bank plans for major programs in the land registry and cadastre, and in the commercial courts. USAID and the Bank will collaborate on a joint modernization program in the commercial courts; USAID will provide TA on court and caseload management, and the World Bank will finance modernization of the court automation systems. In pensions, an area of critical importance to the GOC fiscal outlook, a USAID initiative to provide public education on the need for fundamental reform will pave the way for a major long-term World Bank-funded effort to implement "pillar 2 and 3" pension systems. USAID efforts in advising the Ministry of Economy and the electric utility company on "best practices" in the unbundling of the utility, along with the creation of an independent regulatory authority and competitive power market, will contribute directly to the Government's ability to meet energy-sector conditionality embodied in the Bank's current Economic and Financial Structural Adjustment Loan (EFSAL), and pave the way for a broader Structural Adjustment Loan (SAL) in 2001.

USAID will continue its cooperation with development partners in the GOC in all areas of the program. In fiscal reform, close working relationships have been established at the highest levels of the Ministry of Finance as well as at the working levels, where actual implementation of an Integrated Treasury Operations System is taking place. Daily interaction between USAID implementers and the U.S. Treasury advisors in the Ministry of Finance is crucial as Treasury takes the lead on the budgetary aspects of the integrated System, and this coordination is working especially well. The fiscal decentralization work will require coordination with the Ministry of Finance, the Ministry of Justice as the legal framework for decentralization is being developed, and local government officials as authority and responsibility are devolved from the center. Possible assistance in restructuring and privatization of the *agrokombinats* (large state owned agricultural conglomerates), would involve engagement with the Ministry of Agriculture.

G. Sustainability

Much of the legal and regulatory development necessary for creation of a positive enabling environment for economic growth is expected to be completed in the first part of the strategic plan, thus making the enabling conditions for economic growth sustainable over the five-year Strategy period. Similarly, improvements in GOC fiscal policy gained through USAID assistance, in all likelihood will be firmly entrenched. Further USAID assistance to the SME sector may be required beyond the five-year timeframe in order to ensure sustainability.



PARTNERS:

2.1.1.1 - ICNL, TBD

2.1.1.2 - AED, TBD

2.1.1.3 - STAR, TBD, GOC, Other Donors

2.1.2.1 - IREX, NUT, CCN, CJA

2.1.2.2 - IREX, NUT, CCN, CJA

2.1.3.1 - UI

2.1.3.2 - UI, Association of Cities and Municipalities,
Cities of Varazdin, Rijeka, Osijek and Crikvenica

2.1.3.3 - NDI, IRI, Sabor, Ministries

2.1.3.4 - NCSC, MOJ, Zagreb Municipal Court

***STRATEGIC OBJECTIVE SO 2.1:
MORE EFFECTIVE CITIZEN PARTICIPATION AND IMPROVED GOVERNANCE***

A. Statement of Strategic Objective

Following the 2000 elections, Croatia entered a period of social, political and economic transition. Completing the transition to a western democracy and market economy will require that governance at all levels becomes more transparent, efficient and responsive to citizens' needs. It also will require that citizens maintain a high level of participation in enacting change. Finally, it will require independent media organizations that hold all levels of Government accountable, while providing citizens with the balanced information they need to make choices and participate effectively in a democratic society.

For the purposes of this SO, governance refers to the practices and institutions of the judicial, executive, and legislative branches of Government at all levels. Civil society organizations (CSOs) are defined broadly to include labor unions; political parties; non-governmental organizations; business and trade associations; and youth, church and civic groups, as well as consumer unions and other "watchdog" organizations.

Strategic Objective 2.1, "More Effective Citizen Participation and Improved Governance," will support Croatia's transition by helping the country overcome a legacy of inefficient governance, dysfunctional courts, and political and civil society organizations that often have been disconnected from their constituents. This SO addresses both supply and demand components of democratic transition. USAID's democratization approach to date has focused on the demand side by empowering citizens to elect a national Government that better represented their interests. This aspect of the approach will continue, encouraging citizen involvement while strengthening the CSOs and independent media that support that participation. On the supply side, the approach will promote reforms to increase the capacity and responsiveness of local and national Government, including the judiciary. This Strategic Objective will be applied both nationally and locally. The emphasis will be on improving local governance and promoting citizen participation at the local level, in order to begin the process of building stronger, viable communities. National institutions (selected Ministries and the Sabor, for example) will receive assistance as needs and partners are identified, with much of the national support linking to sub-national and local development.

B. Problem Analysis

1. Civil Society Organizations

Having played a pivotal role in the outcome of the recent elections, civil society's next major challenge is to play a constructive role in anchoring and facilitating democratic and economic reforms. One aspect of that role is to help ordinary citizens understand their rights and responsibilities in a democratic society and to exercise them actively. Another aspect is to improve community life by providing services at the local level.

For civil society to reach its full potential as an agent of change, a number of constraints must be addressed. The existing legal framework must be significantly modified; CSOs' organizational capacity and advocacy skills must be strengthened, along with the institutions that support CSO growth; and CSOs must become more responsive to their

constituents' needs, especially at the local level. Finally, the economy must grow in order for CSOs to build an indigenous financial base of support.

2. Media

Independent media played a key role during the election period, providing citizens with alternative and objective sources of information. Amendments to the Telecommunications Law passed in June 1999, were a major triumph for independent television, enabling the development of a new independent television network. However, further work needs to be done to strengthen the legal framework and the financial viability of independent media. Business and journalistic skills must be improved if independent media is to compete with state media. The new Government has not pressed forward with reforms to depoliticize state media or to prohibit state television from engaging in unfair competition with its main competitor, the USAID-supported independent television network. The current legislative framework is not consistent with European Union standards, which would create a dual-broadcasting system and an enabling environment conducive to free and fair competition for broadcast rights. Finally, the greatest threat to independent media remains a weak economy that impedes its viability.

3. Local Government

Shortly after independence, the Government in 1992 created cities and municipalities as self-governing units to replace the existing administrative system. In addition, there are 20 counties that function as administrative subdivisions of the state (plus the City of Zagreb, which also functions as a county). These 121 cities and 416 municipalities are corporate and political legal bodies with specified powers of local self-government having specific functions as defined in the 1993 Law on Local Self-Government.

However, the law gives localities only limited powers, particularly with respect to revenues and budgets. The HDZ party used its central control of budget and politics to impose its political control over local governments. Beyond this legacy of HDZ control, other problems extant at the local level include inadequate management capacity, lack of transparent financial planning and reporting systems, weak capacity to effectively communicate within local government structures and with the public, and lack of awareness of the value of public participation in the local government decision-making process.

Municipalities are heavily dependent on central Government transfers that can comprise as much as 90 percent of municipal funds and often are allocated in a politicized and non-transparent manner. Although local governments have legal responsibilities, there is no genuine devolution of power to municipalities and they, in turn, are not directly accountable to their constituents. Municipalities rarely seek citizen input in determining priorities. The roles and responsibilities of counties, cities and municipalities in relation to the central Government remain ambiguous. Public administration and accounting skills remain undeveloped and few cities have fully automated these functions. Therefore, local governments are not in a position to assume responsibilities that may devolve to them as a result of fiscal decentralization, and few are deemed creditworthy and capable of incurring debt for capital investments in infrastructure.

4. Political Processes

Croatia's new reformist coalition Government faces the consequences of war and the disastrous economic and political policies pursued by the HDZ Government. Having spent the decade since Croatia's independence in the political opposition and until the election campaign largely disunited, the new leaders have little or no experience in Government, and in many respects are ill-prepared to govern effectively. This challenge is further compounded by the new Government's internal need to successfully manage a six-party coalition, while maintaining external public support for democratic and economic reforms.

The Croatian parliament suffers from a deficiency in infrastructure and resources. Few legislators have expertise in the functioning of a democratic legislature. More than sixty percent of Members of Parliament (MPs) are newly elected and have little or no background in the legislative process. Virtually all MPs lack the skills to conduct effective constituent outreach and involve the public in the legislative process.

Finally, Government ministries are poorly equipped and poorly staffed to maintain reliable communication channels within individual Government ministries and among the numerous different ministries and the Cabinet. The same problems plague the Government's external communications. Improved media and public relations skills are critical to the Government's maintaining public support for reforms.

5. Rule Of Law

Judicial reform will be crucial to further economic and democratic development in Croatia. The existing legal framework does not protect judicial independence and promotes inefficiency. The judicial system is further hampered by a severe lack of administrative capacity, including a dearth of qualified staff, poor training, inadequate equipment, and difficult working conditions. The 1995 political purge of 13 Supreme Court justices and dismissal of 400 judges throughout the country has contributed to a backlog of approximately 1.2 million cases -- 8,000 in the Supreme Court alone. Even the role and authority of the Constitutional Court, a beacon of judicial hope during the HDZ rule, needs improved definition in the legal framework governing the judiciary.

The current Government campaigned on a platform of accelerating judicial reform, but at present the Government does not have a comprehensive Strategy to address the key issues of judicial independence, code and court rule-book reforms, and building of judicial capacity. Current codes and the rule-books that interpret their application are the major obstacles to judicial reform in Croatia. Recent amendments to the Constitution have not guaranteed judicial independence in critical areas such as appointment of Judges.

C. Results Framework

1. Causal Linkages

The Mission goal of a democratic society and market economy that serve as a cornerstone for stability in the region depends upon effective citizen involvement in decision-making, open information flows between Government and the public and responsive, representative governance.

SO 2.1 has three Intermediate Results necessary to achieve the objective of more effective citizen participation and improved governance. They are: (1) More Effective Citizen Participation in Political and Economic Decision-Making; (2) Sustainable and Balanced Commercial Media; and (3) More Efficient and Responsive Governance Systems. These IRs are supported by nine lower level IRs identified in the results framework diagram.

IR 2.1.1: More Effective Citizen Participation in Political and Economic Decision-Making

IR 2.1.1 is the result that contributes to the demand side of the Strategic Objective. Effective citizen participation through CSOs will require an improved legal and fiscal environment in which CSOs can flourish. It also will require that citizens create more CSOs that are engaged in monitoring and advocacy, in order to ensure that citizens demand and receive good, responsive governance. These CSOs will need enhanced organizational capacity to serve and function. This IR will be achieved with the accomplishment of four lower level IRs: CSOs Effectively Advocate and Monitor on Behalf of Constituents (IR 2.1.1.1); Enabling Policy/Legal/Fiscal Environment for Growth of Effective CSOs Established (IR 2.1.1.2); CSO Community-Based Initiatives Expanded (IR 2.1.1.3); and CSO Organizational and Financial Capacity Improved (IR 2.1.1.4).

IR 2.1.2: Sustainable and Balanced Commercial Media

The emerging independence of electronic and print media is founded on current telecommunications and information laws that permit a competitive media environment. However, the nascent business approach to media is not sustainable. Capacity and professionalism must be improved to generate quality and trust, especially of news sources. This will result in further increases in readers, viewers and listeners, which leads to advertising, revenues, solvency and sustainability as genuine business operations. Two lower level IRs, Journalists' Professional Standards Improved (IR 2.1.2.1) and Management and Business Capacity of Media Organizations Strengthened (IR 2.1.2.2), combine to achieve IR 2.1.2.

IR 2.1.3: More Efficient and Responsive Governance Systems

This IR represents the supply side of the SO by addressing the need for capacity of local government to manage resources, establish mechanisms to enhance citizen access to local government, set up transparent and accountable governing procedures that the public can scrutinize, and bring professionalism and improved court administration to the judicial branch. Achievement of this IR will increase Government's capacity to respond to the needs of individuals and groups in a manner that engenders trust and confidence in basic governance. Three lower level IRs, Local Government Capacity to Manage Resources Increased (IR 2.1.3.1), More Transparent and Accountable Executive and Legislative Governance at the National Level (IR 2.1.3.2), and Capacity of the Judicial Branch Increased (IR 2.1.3.3), contribute to the achievement of IR 2.1.3.

2. Critical Assumptions

- The Croatian economy will continue to grow in real terms by at least 3.0 percent annually, enabling CSOs, associations and other private institutions to become sustainable.

- By the end of 2001, new legislation will be enacted that devolves some fiscal and political responsibilities to local governments. By mid 2002, local governments will be able to take advantage of new legislation to generate and expend at least 70 percent of their revenues.
- The EU accession process results in assistance to reform the judiciary, state-broadcast media, and local government, beginning in 2002.
- The GOC introduces judicial reforms in systematic fashion. These reforms conform to EU/Council of Europe standards.

D. Progress to Date

1. Civil Society Organizations

USAID's early program was focused on supporting CSOs that were engaged in providing assistance to war victims, refugees, displaced persons, and returnees. Subsequent USAID-sponsored programs funded a network of women's non-governmental organizations. CSOs in these groups have reasonably well-developed organizational capacity and skills in reconciliation and conflict resolution, non-profit management, fundraising, communication with media and advocacy.

With USAID assistance, Croatian NGOs have become stronger and more effective in campaigning and advocating policy changes. As a result of their efforts, Croatia's first broad-based CSO coalition, Glas 99, organized an effective election monitoring campaign for the opposition electoral victory in January 2000.

Since 1999, USAID has been advising the Government of Croatia regarding a draft of the new Law on Associations. USAID has been the only international donor to support publication of manuals and handbooks in the Croatian language on topics such as fundraising, advocacy, economic activities and tax issues. These materials have had significant impact on civil society development. Trainers specializing in CSO management, who were trained with USAID support, have formed two financially viable training organizations. Another critical component of USAID assistance has been creation of three new regional support centers that will play a vital role in supporting smaller grassroots CSOs.

2. Media

With USAID assistance, the ProMedia activity began in 1995, helping the independent media sector strengthen broadcasters' and journalists' associations, improve journalism standards, and introduce business management for commercial print and broadcast media. By September 1999, when ProMedia II began, it was evident that there soon would be a change in the Croatian Government. As this change became imminent in late 1999, ProMedia II expanded its program to include networking of independent television and radio in order to act as competition to Croatian State media. To date, the independent media project has conducted management training and provided management consultants to various Croatian media to assist their restructuring and enable them to remain solvent in a declining economy. Business associations have been created for the independent radio and television

sectors, and the project continues to work with the Croatian Journalists Association to watch legislation and advocate on behalf of independent media.

3. Local Government

In 1998, USAID initiated a modest, but successful, program in selected war-affected municipalities of Croatia to assist communities with returnees in the areas of municipal finance, investment project development and information and asset management. Target municipalities had populations of one to ten thousand persons, and lessons learned were applicable primarily to small, war-affected municipalities dealing with return issues. Results include a compendium of legislation governing municipalities and a financial analysis model (FAM) that may be of interest to municipalities throughout Croatia.

4. Political Processes

Since 1994, USAID and a few international donors have provided substantial training and technical assistance to democratically-oriented political parties, working with their leadership ranks as well as with activists throughout Croatia on political party strengthening, coalition building, polling, and communications training. This effort helped unify opposition groups prior to the parliamentary and presidential elections, which resulted in their January 2000 election victories.

Following the elections, USAID has continued to support political party strengthening at the local level to help parties rebuild after the leadership went into Government or parliament, and has begun a parliamentary program to assist Members of Parliament (MPs) in representing their constituencies more effectively. USAID also provides communications training for the Government that has included extensive focus group work. To date, competencies in these areas remain weak, and parliament and the executive branch have yet to engage foreign assistance at meaningful levels to improve requisite skills.

5. Rule of Law

The Ministry of Justice has begun this year major legislative initiatives involving revisions to basic legislation, including the Constitution; the Criminal and Civil Codes; the Law on State Attorneys; and the Law on the High Judicial Council (the body that appoints and disciplines judges). Constitutional reforms passed the Sabor in November 2000, and further reforms are expected before the end of the year.

Prior to the elections, the bulk of USAID assistance in establishing the rule of law was provided by ABA/CEELI, which has been active in Croatia since 1993 conducting workshops, symposia, and seminars to increase the professional capacity of the judiciary. The Association of Croatian Judges (ACJ), the Croatian Bar Association, the Association of Croatian Women Lawyers, and the Supreme Court have received training. With USAID assistance, the ACJ drafted and adopted a Code of Judicial Ethics in May 2000.

In September 2000, USAID launched the Municipal Court Improvement Project (MCIP). This activity, implemented by the National Center for State Courts (NCSC) in partnership with the Croatian Ministry of Justice (MOJ), will accelerate civil case processing in the Zagreb Municipal Court and will assist the MOJ and the judiciary to introduce reforms that will promote fair and efficient disposition of civil cases.

E. Program Approaches

The approach under SO 2.1 is to focus activities primarily at the local level, although some support will be directed nationally at strengthening the parliamentary process, court administration and commercial media networks, as well as ensuring that the legislative frameworks are in place to support all activities. National level efforts should positively impact on political, social and economic systems at sub-national levels, and may be expanded at the request of GOC counterparts. Support will center on the three major IRs. Illustrative program approaches include the following:

IR 2.1.1: The basis for this IR is to expand and increase citizen participation by promoting the growth of responsive political parties and CSOs that make citizens' voices heard at the national and local levels. It addresses the demand side through monitoring of Government actions, advocating issues and participating in the processes for good governance. Assistance to political parties will continue in order to develop parties that are democratic in their internal operations and able to reach out to and represent diverse constituencies. USAID also will encourage "watchdog" initiatives that promote transparency in the parliament and local government, and advance the link between elected officials and citizens.

This intermediate result also will ensure that CSOs have the resources they need to flourish over the longer term. To achieve this IR, civil society support will target building CSO financial and organizational capacity, improving the policy and legal environment for CSOs, strengthening the "infrastructure" of resource organizations, and promoting voluntarism and indigenous philanthropy at the national and local level. An activity to strengthen this "infrastructure" will be put in place in summer 2001 as a follow-on to the current AED NGO program. By promoting greater involvement of CSOs in community-based initiatives, civil society assistance will achieve the most important goal of helping citizens improve the quality of life in their communities. A new activity to provide small grants to NGOs at the local level is also currently in design. This new program will encourage partnerships with businesses and Government by requiring matching contributions to accomplish socially significant projects.

IR 2.1.2: The program approach of this IR is to enhance business viability as the best means of fostering sustainable commercial media enterprises. The experience gained to date in providing business consulting to media outlets and conducting business-planning seminars will be extended to fledgling commercial media stations. This capacity is essential in the context of this IR. Also, support will be provided to introduce competent management practices for commercial ventures in the media sector.

To improve professional standards, the Croatian Journalists' Association will continue to provide journalism training concurrently with a train-the-trainers program that creates a pool of journalism experts. In addition, a suitable journalism code of ethics that responds to Croatia's new future will be developed. A university partnership to improve the teaching of journalism and to boost professional standards may be considered, subject to the availability of funds. Croatia's journalists currently practice cutting-edge investigative journalism, but their efforts to promote transparency could be enhanced by stronger legislation guaranteeing freedom of access to information.

IR 2.1.3: This IR is aimed at capacity building of governance institutions. For example, local governments will be required to develop greater responsiveness to constituents and assume more responsibility following fiscal reform. Meeting this challenge will require increased management and administrative skills, and results should include an improved local environment for investment and business-friendly practices, and more citizen participation in local governance. In order to achieve these results, a new activity, the Local Government Reform Project (LGRP), was initiated in late FY2000. The model for the project is to identify and work with “pilot cities” or “demonstration sites” in order to develop best practices in various facets of local government and introduce these best practices to other local governments and officials. The LGRP also will assist the GOC in developing a policy framework for local government reform, and will strengthen the leading municipal association, the Association of Cities and Municipalities. A new activity still in the design phase, will provide additional assistance in the area of municipal finance.

At the national level, USAID assistance will help key ministries communicate more effectively within Government, with the public, and with the press. In parliament, the approach is to help the Sabor conduct its legislative affairs professionally and ably, while at the same time representing Croatia's mainstream political constituencies effectively. Assistance in this area will focus initially on constituent services, but may expand to include public outreach, internal communications, strengthening the committee structure, and building management capacity.

Assistance to all three branches of Government will significantly increase transparency of Government operations at both the national and local levels. For example, the introduction of best practices such as public budget hearings, improved municipal management systems, and simplified business registration procedures should reduce the potential for corruption in target municipalities. Improved court and caseflow management in the municipal courts should promote transparency and predictability in court operations. And a strengthened committee structure in the Sabor will increase its ability to perform its oversight role.

Building capacity to use information technology (IT) will be included in each activity as appropriate. For example, civil society activities will promote use of the internet to share advocacy strategies and materials on CSO management, as well as to post notices of grant competitions. Independent media can use electronic publishing as a tool to increase readership and revenues. The Local Government Reform Project will introduce or enhance web sites for each pilot city; at least one city will receive assistance with a geographic information system. An upgrade to the Sabor's web site and automation of the Zagreb Municipal Court are examples of other planned IT interventions.

F. Development Partners

USAID implementing partners for this SO include: Urban Institute, the implementer for the local government project; NDI, IRI, ABA/CEELI, and the National Center for State Courts (NCSC). IREX has been the implementer for the media project since 1995 and is scheduled to continue to 2004. The American Center for International Labor Solidarity (ACILS, the Solidarity Center) will continue to provide assistance to labor unions. The Academy for Educational Development (AED), the International Center for Non-for-Profit Law (ICNL), and the STAR Project of World Learning strengthen civil society organizations.

Croatian non-governmental partners in improving governance include the Association of Cities and Municipalities, the Association of Croatian Judges (ACJ), and the Croatian Law Center (CLC). In the media sector, the Croatian Journalists' Association (CJA) champions journalists' rights and promotes increased professionalism through training. The Association of Independent Radio (AIR) and the Association of Independent Television (NUT) contribute to the public dialogue on media legislation and other issues in the media sector. These two associations also have been leading sources of balanced alternatives to Croatian state media. Civil society partners include the six political parties represented in the ruling coalition; four of five of the major labor union confederations; and GONG (Citizens Organized to Monitor Elections). Ri-Centar, MI, and the Center for Peace, Non-Violence, and Human Rights serve as resource centers for CSOs in Rijeka, Split, and Osijek respectively, together with another three dozen partner organizations that provide national leadership for the Croatian non-governmental sector.

Primary Croatian Government partners include the Sabor, and the Ministry of Justice and Local Government (MOJ), and the Government Office for NGO Coordination, as well as the Zagreb Municipal Court and municipal governments in Local Government Reform Project pilot cities.

Key donors and international organizations working with USAID in this SO area include the EU, Soros Foundation, OSCE, and the Council of Europe. Several bilateral donors, including the Canadian, German, British, Dutch, and Swedish Governments, have active democracy support programs in Croatia. DFID is launching a new Strategy to strengthen civil society in Croatia. The World Bank and EBRD have lending programs that dovetail with judicial reform and local government activities. USAID expects that, as accession approaches, the EU will become the largest international donor in Croatia, although formal accession is not expected before the end of the planning period. In particular, European Union support to state media reform will be critical for the success of the USAID media Strategy outlined above.

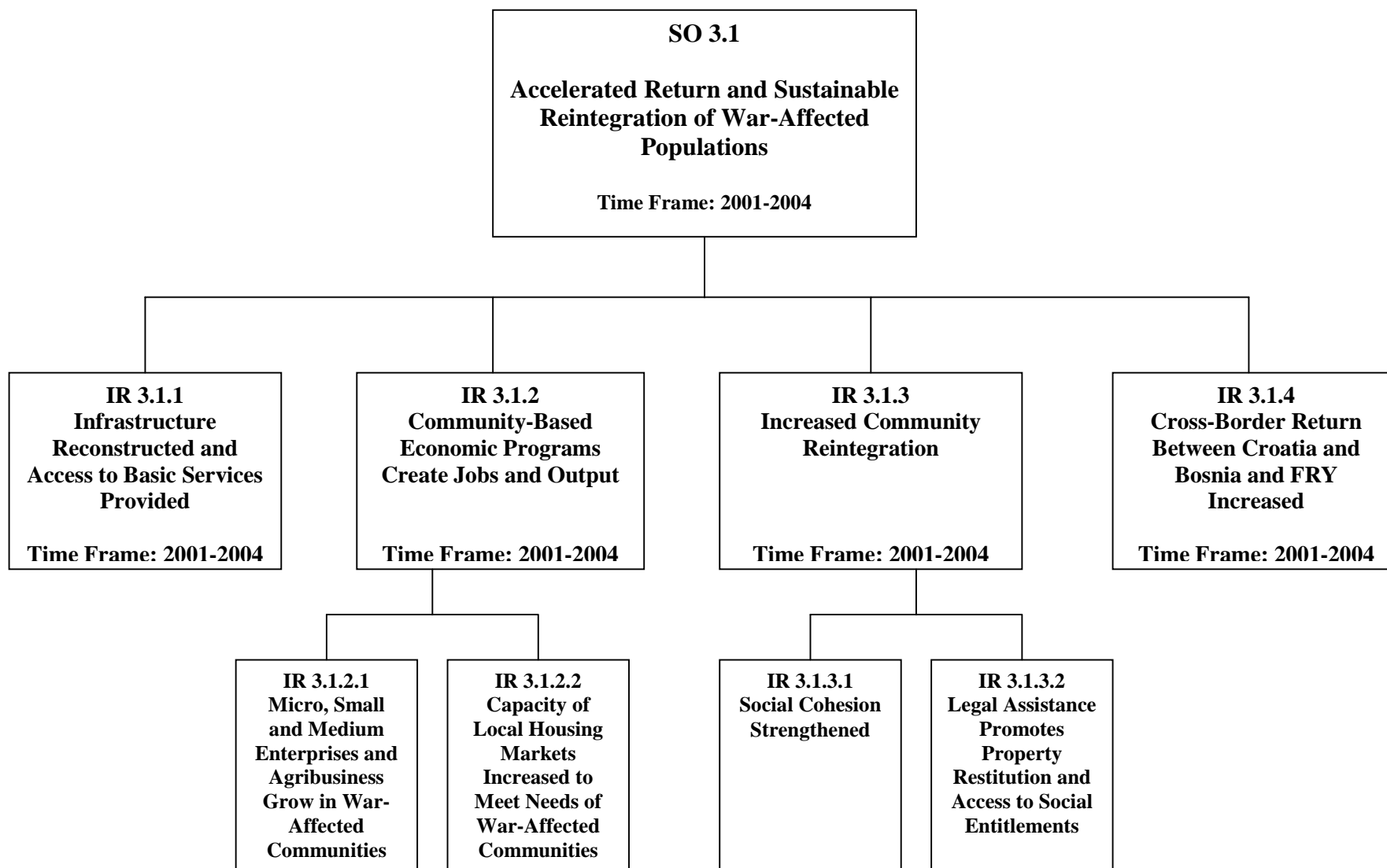
G. Sustainability

USAID expects that Croatian citizen participation in all levels and branches of governance will have increased by 2005. Significant progress will have been made in reforming local governance, including passage of legislation on fiscal decentralization, on local government, and on constitutional changes defining territorial division. It will take time for municipalities to absorb these monumental changes. By the end of the timeframe for this SO, improvements in public administration skills, management of resources, and mechanisms to increase citizens' participation and promote transparency will be taking hold in targeted cities. It will take at least ten years for these reforms to spread to cities that have not received significant foreign assistance.

The sustainability of executive, parliamentary, and judicial reforms is more difficult to predict. Current progress in institutional reform is slow and commitment to reform is uneven across all three branches of Government. By 2005, at least one set of presidential and parliamentary elections will have taken place, and it is difficult to predict whether institutional reforms adopted in Government and parliament will have become entrenched enough to survive a turnover in elected officials. Within the Strategy period, meaningful reforms in the municipal courts will have been introduced, but reform of the judiciary and its supporting institutions will likely require an additional fifteen years.

At the end of this Strategy, USAID-funded media assistance in Croatia will conclude. Several commercial media will be sustainable, if economic growth begins and state broadcast media are reformed. Complete sustainability can never be achieved in a market economy, and some media will find it difficult or impossible to continue operations. Key partner organizations such as AIR, NUT, and CJA that lobby on behalf of a strong, independent media sector and uphold professional standards will be sustainable on their own revenues.

In 2005, CSOs will have honed their advocacy, management, and fundraising skills, and will have become more responsive, service-oriented, and increasingly visible at the local level. Cooperation with business and Government on community initiatives will have increased. However, as noted earlier, USAID does not expect that civil society organizations will be sustainable on local resources by the end of the timeframe for this SO. By that time, patterns of indigenous philanthropy will be taking hold and a favorable legal framework will likely be in place. A handful of intermediate support organizations and resource centers will have established themselves as anchors for the non-profit sector, although they will remain largely dependent on foreign donors for funding. Two or three local grant-making programs or foundations may be in formation, but not fully sustainable.



***STRATEGIC OBJECTIVE 3.1:
ACCELERATED RETURN AND SUSTAINABLE REINTEGRATION OF
WAR-AFFECTED POPULATIONS***

A. Statement of Strategic Objective

The objective is to achieve accelerated, sustainable return in selected communities that have demonstrated their commitment to the process of minority return. Infrastructure reconstruction, housing reconstruction,¹ economic and social revitalization, legal assistance (e.g. to regain property), and cross-border return programs are essential to achieve this result. USAID's assistance will help those who have returned remain and will pull home other potential returnees. USAID's increased activity under this SO made possible by the allocation of supplemental funds by Congress for Croatia's Stability Pact Return Project, will help meet the needs of the significant increase in the number of "spontaneous returns" in CY2000. Previously, USAID assistance was disbursed throughout many war-affected areas, but this Strategy describes how the Agency will focus on a smaller number of selected communities with a more comprehensive package of assistance. In particular, the new Strategy will concentrate more on activities that encourage the return of economically active people. The timeframe for funding is FY 2001-2003, with implementation continuing through 2004. In 2003, the Mission will determine which SO 3.1 activities should be continued under other SOs.

B. Problem Analysis

To date, USAID's return-related assistance concentrated on infrastructure rehabilitation activities, economic revitalization, and legal assistance/human rights monitoring in accordance with U.S. foreign policy objectives to assist the Government in implementation of the Dayton Accords and the Erdut Agreement.² Up until the year 2000, USAID's efforts to provide resources for returnees from all ethnic groups were slowed significantly by the previous Government's obstruction of the minority return process. Until 2000, almost all of the Government's reconstruction assistance was provided for areas where Croats were returning to their pre-war places of residence. Moreover, the former Government slowed the return of minorities through bureaucratic means, and ethnically Serb citizens (living abroad and within Croatia) experienced great difficulties in securing pre-war rights, from citizenship documents to repossession of houses and social benefits.

The new Government came to power in 2000 and voiced its support for a fair return process for all Croatian citizens. These political changes, together with deterioration in living standards in places of refuge such as FRY, caused an upsurge in minority returns. As of November 2000, UNHCR had registered 26,615 refugee returns, primarily Croatian Serbs, thus far that year. This represented an increase in comparison with the 1999 rate of return, when a total of 18,581 refugees returned throughout the year. As a result of the increase in return and the new changes in the Government, USAID increased funds for SO 3.1 to meet the needs of the bigger pool of returnees and in order to take advantage of the Government's

¹ Done primarily by the European Union and other donors including State/PRM, as well as the Government

² Croatia is a signatory of the Dayton Agreement and, as such, committed itself to facilitate the return of citizens displaced in the region. This primarily affects Croatian Serbs who are currently displaced in BiH (primarily the Republika Srpska entity) and FRY, as well as Bosnian Croats who are currently living in Croatia. In the Erdut Agreement, the Government committed itself to ensure the peaceful reintegration of this region into its territory and the peaceful return of Croatian citizens to this region.

new support for the return process. To date, however, the Government and international donors have not been able to keep up with the quickened pace of return, so some returnees went back to their places of refuge or “commuted” between the two places³.

For its part, the new Government has committed itself to eliminating the legal and administrative barriers to the return of minority citizens, but to date substantial policy reforms have not been implemented. The Government contends that funds are not available for enabling the remaining returns, primarily ethnic Serbs in refuge in BiH/Republika Srpska (30,000) or the Federal Republic of Yugoslavia (200,000), and so support must be provided by international donors. The Government’s housing reconstruction priorities still favor ethnic-Croat returnees, so international donors are required to fill the funding gap for reconstruction of Croatian Serb-owned homes. For instance, 14,000 potential returnees, primarily Croatian Serbs, have applied to return and their return has been accepted, but they cannot return due to the absence of reconstruction assistance or because their homes are currently occupied. While donors including the EU and the U.S. State Department’s Bureau for Population, Refugees, and Migration (BPRM) are engaged in housing reconstruction, the available resources are woefully inadequate relative to the need. Moreover, ethnic tension is still a minor threat in war-affected areas due to economic depression, the presence of some 140,000 Bosnian Croat refugees (sometimes called “settlers” due to their proclaimed intention to remain), and the activities of right-wing parties. International assistance is required to rebuild infrastructure and housing, promote economic and social revitalization, legal assistance, and cross-border return.

The new Government sought international assistance through the Stability Pact for South East Europe and received \$55 million in pledges for its “Stability Pact Return Project.” The USG pledged \$15 million to this project (\$10.5million implemented by SO3.1/USAID and \$4.5 through State/PRM. This project identified financial requirements for the return of approximately 16,500 Croatian citizens, primarily ethnic Serbs, who have already applied to return. However, since their return is currently blocked because their homes are either destroyed or occupied, the \$55 million Stability Pact project will be spent primarily on reconstruction of homes for returnees and construction/reconstruction of alternative accommodation for persons currently occupying these homes (primarily Bosnian Croats who do not intend to return to BiH). USAID’s contribution will complement housing reconstruction with infrastructure and economic and social revitalization initiatives.

Reconstruction of housing and infrastructure (power, water, waste management, schools, community centers) lags behind the pace of actual returns. Between 2000-2003, the Government plans to allocate funds for the reconstruction 29,950 homes.⁴ Undoubtedly, these funds will not cover both the costs of reconstruction of homes for returnees and construction of alternative accommodation for the 140,000 Bosnian Croats who have, to date, expressed

³ Returnees may go back to their places of refuge for a myriad of reasons including: house occupied by a Bosnian/FRY Croat and repossession was unsuccessful, house destroyed and reconstruction assistance not available, jobs not available, schools not rebuilt in pre-war villages, cost of living higher than the place of refuge. Due to housing shortages, the Government and donors discourage the practice of “commuting” if a person keeps a (temporary) occupancy rights to a housing unit in his/her place of refuge while returning to his/her pre-war home.

⁴ This data is based on the MPWRC’s proposal to the Government for the period 2000-2003. However, it has not passed the Croatian Parliament (Sabor). Should it be approved for this year, incremental funding will still have to be passed each subsequent year.

their intention to remain in Croatia.⁵ During this period, the Ministry of Public Works, Reconstruction and Construction (MPWRC) also has proposed spending approximately \$64 million on reconstruction of schools and \$25 million on reconstruction of public utilities.

USAID continues to be the primary international donor for reconstruction of infrastructure, particularly power and water. In 2000, after the Congress appropriated supplemental funds for Croatia, USAID pledged \$5 million for joint electrification projects in return areas with the Croatian Power Company (HEP). This allocation was a result of USAID's analysis that one of the main barriers to returns in rural areas is the absence of electricity. Over 200 settlements throughout the war-affected areas are still without electricity.

Recognizing that sustainable returns of young, economically-active families require job opportunities and viable community services, this Strategy raises the level of activity in the areas of economic and social revitalization. There is an absence of data about the level of economic activity in Croatia's war-affected areas. However, Government counterparts consistently cite economic revitalization of war-affected areas as a neglected area that is essential for both sustainable return and ethnic reconciliation. The World Bank recently completed a poverty assessment that found poverty is more problematic in rural areas and is more frequent among Croatia's minority population. FLAG's analysis of employment in select return areas found that the majority of industries in pre-war rural towns are now closed. While approximately 70 percent of the population in rural areas used to work full-time and supplemented family incomes with subsistence agriculture, few have their jobs back and most are now relying on small agricultural production as a stop-gap measure. Thus, new businesses, in particular new SMEs and agricultural initiatives, are looked to as the future engine of income and employment for returnees. In some cases, however, short-term job programs may be needed to help returning families get on their feet.

Community-building activities are also necessary to prevent an upsurge in ethnic tension once the rate of minority return increases, and to promote long-term reconciliation. To date, ethnic tension has been kept to a minimum due to low return rates that did not "threaten" the ethnic majority. However, tension could increase after the returns in 2000 and local elections in the first half of 2001. USAID community activities, such as support for village boards, community centers, women's groups, and local NGOs, will seek to start a constructive dialogue between ethnic groups. Community-building activities increase the capacity of local government and the participation of all local interests in governance and community decision-making. Likewise, follow-on support to the Croatian NGOs providing pro bono legal assistance will be continued, since securing property restitution other legal rights is nearly impossible without it.

During the HDZ Government era, the right of Croats from Bosnia and Yugoslavia (BIH/FRY) to continue to occupy someone else's home, even if the homeowner has returned to Croatia, was unquestioned. Moreover, the HDZ encouraged Bosnian Croats to remain in Croatia to prevent the return of minority Serb citizens. In this environment, few Bosnian Croats voiced an interest in returning to Bosnia since their option to remain seemed secure and for many, returning to Republika Srpska did not appear viable until recently. Since the election of the new Government, Bosnian Croats have begun to realize that, in some cases,

⁵ Among the 140,000 Bosnian Croats in Croatia, approximately 90% have expressed their intention to remain in Croatia. According to the Government, 13,300 housing units, primarily owned by Serbs in exile, are currently occupied by ethnic Croats from BiH and FRY.

return is an option and possibly a necessity. USAID will support the individuals and groups of individuals interested in returning by informing USAID/Sarajevo of emerging return patterns, by providing financial support for pro-return Bosnian Croat associations, and by working together to implement projects that support cross-border returns (such as regional transport links and infrastructure). In time, the Mission hopes to engage USAID/Belgrade in a similar effort.

C. Results Framework

1. Causal Linkages

The results framework diagram presents SO 3.1's new strategic framework. Under the Strategic Plan for Croatia prepared by USAID in 1997, USAID's return program operated under the Strategic Objective "reintegration of war affected populations". At that time, the program primarily addressed reintegration of populations in Eastern Slavonia, which was then shifting back from United Nations control to administration by the Croatian Government under the terms of the Erdut Agreement. The intermediate results were:

- Affected populations become economically productive members of society
- Human and civil rights protected
- Increased problem solving by civil society

In the last three years, Eastern Slavonia has been peacefully reintegrated into Croatia and the focus of USAID's assistance has expanded to other regions to follow changed return patterns, and has become more directly focused on the specific needs of the growing number of returnees. A new Strategic Objective, "Accelerated Return and Sustainable Reintegration of War-Affected Populations," is proposed to reflect the essential elements to create an environment for sustainable return. The indicators identified for this Strategic Objective are: (1) the change in the overall return rate and (2) the change in the number of returnees who are economically active people in USAID's partnership municipalities. Four Intermediate Results have been identified as necessary to achieve this new Strategic Objective. In all cases data collected to measure results will be disaggregated by gender, ethnicity, and returnees/remainees.

IR 3.1.1: Infrastructure Reconstructed and Access to Basic Services Provided

Critical infrastructure is still unreconstructed in areas where refugees are currently returning or would like to return. Infrastructure rehabilitation will provide the basic public utilities (water, electricity, waste management) and operational public buildings (schools, community centers, clinics) in order to break down the existing barriers to large-scale return and economic revitalization. Results will be measured by the change in the number of operational public buildings and the number of new connections to public utility services. In 2001, particular emphasis will be placed on reconstruction of electric power, as a result of a \$5 million joint project with the Government and the Croatian electricity company made possible by the FY2000 Supplemental appropriation.

IR 3.1.2: Community-Based Economic Programs Create Jobs and Output

To date, pensioners have been the largest group of returnees in Croatia since due to the absence of jobs, economically active people have not returned in great numbers.

Economic revitalization activities will offer a menu of support programs to agriculture and small business with an overall goal of job creation to enable the sustainable return of economically active people. Economic development initiatives will also stimulate the local housing market, both to solve housing shortages and stimulate job creation in return areas. Results will be measured in USAID's partnership municipalities by the number of operating small businesses, the number of people accessing credit and resultant jobs created, the number of agricultural associations and cooperatives registered, and the output of firms directly or indirectly engaged in construction of housing for returnees and remainees.

IR 3.1.3: Increased Community Reintegration

Croatia's return areas are predominantly remote and devoid of social and cultural activities. Moreover, there is still a possibility for inter-ethnic violence if communities lack mechanisms for confidence-building and ordinary social interaction. Returnees also need assistance in regaining their legal rights – from property to social welfare – in order to reintegrate into Croatian society. Legal assistance will help returnees regain property and social welfare rights, while local initiatives will promote reconciliation, co-existence, and a sense of community in isolated, war-torn areas. Two important mechanisms the promotion of social cohesion are reconstruction and management of community centers and formation of village boards. Results will be measured by the number of organized local initiatives, the number of citizens participating in local initiatives, the number of registered local civil society organizations, and the number of organized and recognized village boards. The results of the legal assistance will be measured by the number of clients served and the percentage of cases they resolve.

IR 3.1.4: Cross-Border Return Between Croatia and Bosnia and FRY Increased

During the HDZ Government, Bosnia and Yugoslavian Croats were encouraged to settle in Croatia and were provided with "temporary" rights to housing (usually homes owned by Croatian Serbs in exile). Now that a new Government has been elected and is supportive of the return process, Bosnian Croats are realizing that they may have a better life in their home country. USAID will support Bosnian Croats interested in return to Bosnia through support for pro-return associations, and reconstruction of cross-border transport links, as well as infrastructure repair and economic assistance to the communities left by the Bosnian Croats, thereby making room and improved conditions for Serb returnees to those locations. This program is being developed in close cooperation with USAID/Sarajevo and with State/PRM in both Croatia and Bosnia. Conditions permitting, this cross-border initiative will be expanded to the FRY, where perhaps as many as 250,000 Croatian Serb refugees are located. Results will be measured by the change in the rate of return to Croatia, as well as the change in the number of returns of Croats to Bosnia and FRY and by the change in the number of applications to return in all three directions.

2. Critical Assumptions

- Funding: USAID funding for return and reintegration will continue at present levels for two years and decrease slightly for the last two years of this Strategy (FY 2001-2004).
- Return trends: Return levels will continue at or above the present pace for the coming two years, but level off afterwards. The security situation will continue to be

relatively stable in ethnically mixed areas, with only minor harassment of minority returnees. Croatia's relations with its neighbors FRY and Bosnia will remain stable or improve and borders and transport linkages will become more open, facilitating freedom of movement and the return process. It is also assumed that the presence of Bosnian Croats in minority-owned homes will continue to slow the process of housing repossession (despite changes in legislation). Likewise, it is assumed that the majority of Bosnian Croats will remain in Croatia, although return to Bosnia will increase slightly.

- Housing: Improved rates of housing reconstruction and housing repossession are critical for success of USAID's return assistance program, but the Agency depends primarily on the Government and the EU to fulfill these goals. Government reconstruction funding will continue to be primarily for Croat returnees, leaving the international community to foot the bill for reconstruction of homes for Serbs. It is assumed that the Government will pass and enforce new legislation to speed up the process of property restitution for minority homeowners. The EU will continue its housing reconstruction activities.
- Government involvement: The Croatian Government, selected local governments and public utility companies will continue to cooperate with the Agency as it implements this program. Croatian public utility companies will provide some cost-share funds for our projects (primarily through design and supervision). The Croatian Mine Action Center, CROMAC, will continue to supervise and implement de-mining efforts throughout Croatia.
- Democratization: Local elections scheduled for April 2001 will be free and fair and result in election of more moderate municipal administrations in many of Croatia's return areas. As a result of the local elections, Serbs will have more representation in local administrations and the power-sharing agreements will be peaceful.

D. Progress to Date

The Problem Analysis section above provides the background information on the political environment that has affected the pace of return to Croatia. This section explains how USAID's programs to date have assisted the return process in spite of these constraints, and describes a list of lessons learned that will be applied to future activities.

USAID's main implementers in fulfilling its previous Strategy were: International Organization for Migration (IOM), Urban Institute, Opportunities International/NOA), FLAG/University of Delaware, and America's Development Foundation (ADF). IOM became USAID's partner in November 1997 to implement the Return Assistance Program (RAP), a program to assist with infrastructure reconstruction in municipalities facilitating the process of return.

The results achieved through IOM in 1998-99 fell short of expectations. The program target was to facilitate the return of 30,000 over this two-year period, but only 18,335 returns were reported in RAP's 15 partnership municipalities. The figures were lower than expected for a number of reasons, including the extensive time required to persuade local officials to remove obstacles to return and partially due to IOM's inexperience in reconstruction activities.

During 1999, USAID funded a one-year local government activity that provided direct technical assistance to small, war-affected municipalities to develop their administrative capacity and improve public services delivery. Eleven municipalities in Eastern Slavonia benefited directly from the program while more than 30 were indirectly helped through dissemination. Although more could be done in these communities, the Mission decided to switch its focus to other geographic areas also affected by the conflict during this Strategy period. At the same time, the new local government program managed by the SO 2.1 team will include at least one larger war-affected town.

In the area of human rights monitoring and protection, USAID funded ADF to develop and finance a network of local NGOs providing *pro bono* legal assistance in return areas. These community-based legal aid offices assisted 70,000 clients with legal matters related to return in 1998 and 1999. These NGOs became good service providers and helped returnees secure legal rights, such as identity documents and pensions. However, they were not able to close many property restitution cases, since this primarily depends upon changes in Croatian legislation. Moreover, these NGOs have not yet become self-sustainable and continue to seek funding from USAID and other international donors.

USAID, in an attempt to increase income-generating opportunities in war-affected areas, offered technical support for private enterprise and agricultural development through FLAG as the implementing partner. FLAG assisted a total of 16,517 beneficiaries, including private firms, agricultural cooperatives, agricultural associations, and individual farmers in war-affected areas. By the end of 1999, the NOA Credit Cooperative micro loan project implemented through Opportunity International had cumulatively approved more than 1,200 loans and had disbursed more than 1,000 loans valued at \$5.5 million to small-scale farmers and entrepreneurs, mostly in Eastern Slavonia.

E. Program Approaches

While the Government and the EU will address housing repossession and reconstruction, USAID will address the remaining barriers to return: lack of infrastructure and services, lack of economic opportunities, community tensions, need for legal assistance to secure rights for returnees, and the need for cross-border return programs in support of Bosnian Croats who are interested in return to BiH. In all aspects of the program, the primary target beneficiary group is the returnees. Given that today's returnees are primarily Serbs and that the Croatian Government has already provided assistance to enable the return of ethnic Croats, most of USAID's assistance will benefit Serb returnees. However, a portion of USAID assistance also will assist the reconstruction and revitalization needs of all ethnic groups throughout our partnership communities, since assisting only one ethnic group could spur ethnic tensions. In cases where goals coincide, Croatian officials and Croatian public utility companies will become our partners and beneficiaries.

This proposed Strategy reflects significant changes in return patterns throughout Croatia since the previous Strategy was prepared in 1997. The program is now operating in all of Croatia's war-affected areas, with the emphasis moving from the east to the north and south. This change in priorities reflects current return patterns. The SO 3.1 team has also changed or is in the process of changing its implementing mechanisms. Political work (e.g. identifying and strengthening local leaders' support for return and reconstruction) for all aspects of the program now is done directly by USAID staff to ensure consistency with U.S.

foreign policy objectives. Additionally, the infrastructure construction works are carried out by a construction management contractor with extensive overseas infrastructure experience and soon a number of additional implementers will be brought on board for the economic and social revitalization programs. Most importantly, the two major program components – the “hardware” of infrastructure repair and the “software” of economic, social and legal assistance – have been brought together both programmatically and geographically to ensure maximum combined impact. This comprehensive, integrated approach allows the Mission to leverage all aspects of its assistance in select municipalities to provide a package of assistance supporting sustainable returns. These new implementers will address a number of cross-cutting issues, such as local democracy, rule of law, and support for SMEs. The results of these programs will partially depend upon country-wide programs under other SOs seeking policy changes in rule of law and creating a business-friendly environment. In particular, war-affected areas are impacted even more than the rest of the country by the slow pace of land registration, legislation and policies for a strong SME sector, privatization, inefficiency of courts, and limited capacities of local governments.

Possibilities to expand access to and capacity to use information technology in war-affected areas will be embedded into all aspects of the program. For instance, the program will seek to bring new technology to war-affected areas by offering computers, internet access, and computer training as a part of its economic and social revitalization programs as a mechanism to bring people together, decrease isolation, and introduce new skills to the community. Likewise, vulnerabilities to corruption have been identified and anti-corruption will be mainstreamed into the program. For example, reconstruction projects will be identified with input from citizens, not only local administrations, in order to improve transparency and to avoid a situation whereby local politicians can “take credit” for bringing USAID funded projects to “special constituencies”.

F. Development Partners

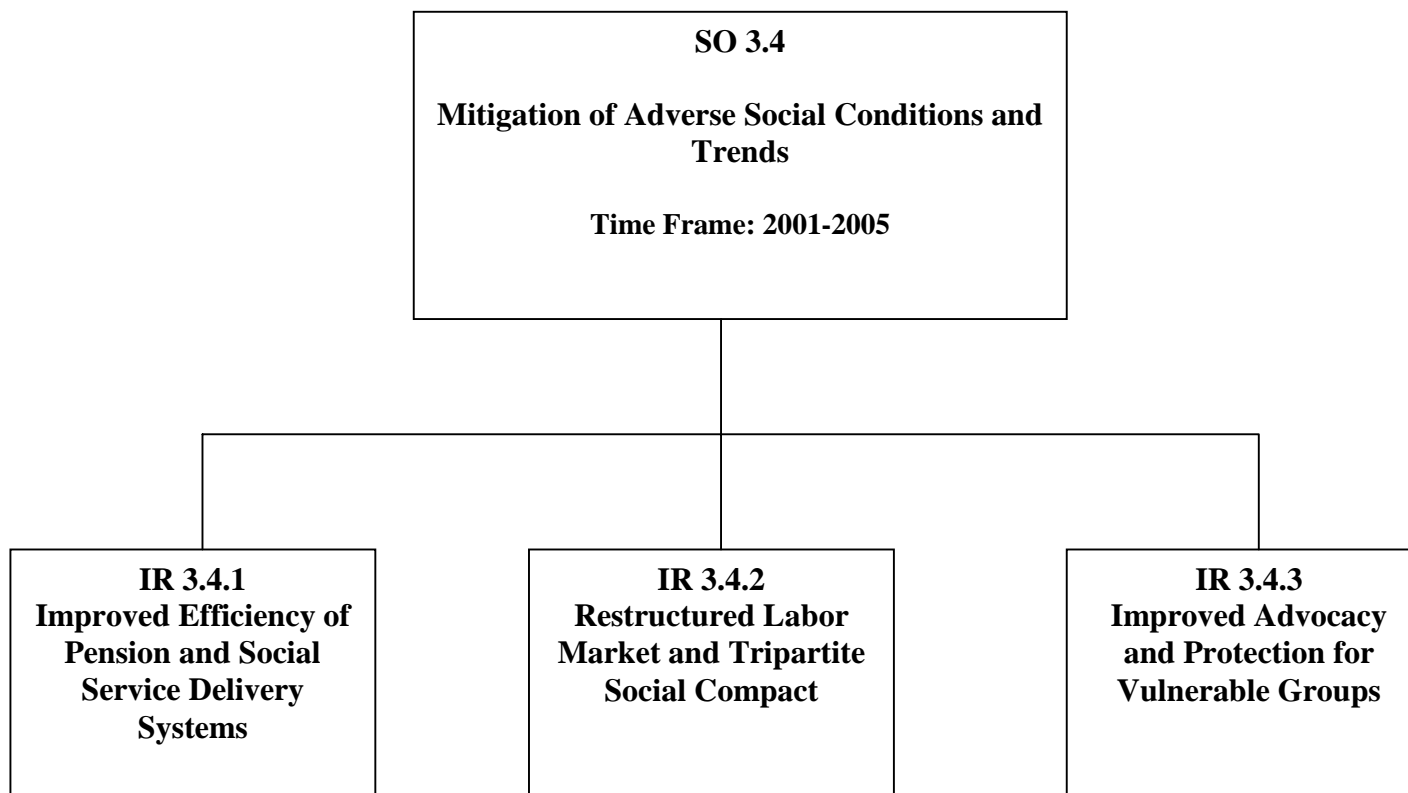
USAID will continue to leverage return assistance by cooperating with the Government and other donors. One of USAID’s main partners in reconstruction has been the European Union through its implementing partner, Arbeiter-Samariter Bund (ASB). Since the Agency cannot reconstruct homes and EU/ASB is primarily involved in this activity, USAID and EU/ASB are natural partners.

To date, USAID has not been able to rely upon the Croatian Government to reconstruct homes in areas where the Agency is providing infrastructure repairs, primarily because the Government’s funds have almost exclusively gone for reconstruction of Croat-owned homes. On the other hand, USAID has been able to develop a cost share model with HEP (the Croatian Power Company) through which USAID buys materials and HEP designs the project, provides construction supervision, and technical labor. On water projects, USAID relies upon “Croatian Waters” to provide design and supervision with construction carried out by private Croatian construction firms. However, HEP and Croatian Waters’ reconstruction budgets are continuously declining, calling into question their ability to meet cost sharing in future projects. The Mission is currently discussing this problem with the Ministry of Public Works, Reconstruction and Construction (MPWRC). It is probable that alternative sources of funding may be necessary. Alternatively, the Mission may have to increase its portion of the bill. Nevertheless, USAID would insist that the Government (e.g.

HEP and Croatian Waters) bear at least design and supervision costs, since their participation is critical for political and technical reasons.

G. Sustainability

The core of this new Strategy is to address the needs of selected communities to support sustainable return. Key to this Strategy is that all elements of the program will work together to address the short-term and long-term needs of a community. As an example, a one-time USAID project, infrastructure rehabilitation, has lasting results since the system is reconstructed and handed over to the domestic public utility company. Other elements, such as community building and cross-border return programs are likely to require repeated interventions. Likewise, the economic interventions will depend on local mechanisms, such as community savings and loans, to ensure sustainability.



STRATEGIS OBJECTIVE 3.4:
MITIGATION OF ADVERSE SOCIAL CONDITIONS AND TRENDS

The Mission has tentatively decided to adopt a fourth Strategic Objective, **Mitigation of Adverse Social Conditions and Trends**. This decision reflects the view that social conditions are a very significant factor in the political economy of Croatia at this time, and could be determinative in the success or failure of both economic and political reform. The increase in resources available for assistance to Croatia makes it possible to focus specifically on social transition issues. However, the limited time available to the Mission between Congress's appropriation action for FY 2001 and the deadline for this Strategic Plan has precluded careful assessment of the social issues. Therefore, the Mission plans to undertake additional analyses of social transition topics early in 2001, and to present a more fully-developed SO framework with our FY 2002 R4 in May 2001. In the present document, we present a "work in progress" -- the result of analysis already undertaken, primarily in the area of labor and workforce issues, and an outline of possible assistance activities. In resource terms, this SO will be very modest relative to the other SOs and will be closely coordinated with them, particularly SO 1.3.

A. Statement of Strategic Objective

Croatia suffers from social problems typical of transition countries, including high unemployment, increasing income inequality, costly and inefficient health, pension and social welfare systems, disaffected youth, a rising rate of drug abuse, and declining school enrollment. These problems are a legacy of both the socialist decades and the breakdown of the economy since independence in 1991. The Balkan conflict of 1991-95 and the policies of the Tudjman regime also contributed significantly to neglect of social issues and hence to their exacerbation. As economic restructuring picks up momentum in the next few years, unemployment and fiscal austerity are expected to increase social stresses, yet public opinion surveys indicate that Croatian voters hold high expectations for improved social conditions accompanying economic recovery under the new Government. Failure to deliver on these expectations could seriously erode popular support for reforms and endanger political stability.

Under this Strategic Objective, USAID will undertake modest and carefully targeted interventions aimed at contributing to the public-private dialogue on social reform, and supporting certain of the Government's social transition initiatives, particularly on labor and pension reform. Building on the ongoing program of support to labor union development and labor participation in decision-making on economic reform, USAID will support the GOC's tripartite discussions with unions and employers on issues of labor code reform; privatization and liquidation of state-owned enterprises including related downsizing and workforce adjustment; skills upgrading; wage policy; and labor-related regulatory reform. The tripartite process is aimed at achieving a social pact among the three interests under which they can work together toward economic reform and growth.

USAID will also play a minor, but important role in pension reform by helping the Ministry of Labor and Social Welfare prepare for changes that will be financed under a World Bank loan. Other initiatives under this SO may include efforts to improve health care policy and delivery at the local level, public health information campaigns on key issues (including HIV-AIDS), post-conflict psycho-social assistance, youth and educational

initiatives and programs targeted at minority and women's issues including international trafficking. In the later years of the Strategy, when SO 3.1 is expected to be phased out, SO 3.4 is likely to assume responsibility for remaining work with returned minority refugees and other vulnerable groups affected by the conflict of 1991-95.

B. Problem Analysis

Like virtually all transition countries, Croatia has historically offered its citizens generous and broad-based social benefits, but these have suffered since independence from inefficiency, unsustainably high cost and payment arrears. Despite a failure to target social benefits to those most in need, and evidence that the most vulnerable in fact receive the least in social protection, Croatia's poverty rate is remarkably low – 8.4 percent by a measure of absolute poverty and 4 percent in relative terms, according to the World Bank. While this poverty rate is much lower than the Eastern Europe average, income inequality is high and growing, and a recent public opinion survey revealed that some 80 percent of the population perceives itself to be poor. This perception is the likely result of negative trends, causing respondents to compare their current and past conditions unfavorably.

Restructuring the pension and health systems is a high priority for the Government and a condition imposed by the World Bank and the IMF for future structural adjustment lending. Progress to date has been slow, however. In an initial step, the Ministry of Finance has moved to bring the pension and health funds "on budget", but the introduction of a "pillar two" program – a voluntary program of worker contributions to be invested for long-term growth and future income – has been delayed until 2002. To help prepare for the new system, USAID has been asked by the Ministry of Labor and Social Welfare to support a public education campaign that will explain the concepts of private retirement savings and investment to the Croatian public. The request also includes training for managers of the "pillar two" pension fund.

Given the country's high unemployment rate – whether one accepts the high estimate of 22 percent or the low of 12 percent (which takes account of the "gray" economy) -- as well as the prospect of increased job losses and a rising level of long-term joblessness, it is apparent that the most serious cluster of social transition issues in Croatia are those associated with labor and employment. The problems are complex and rooted in multiple causes – a rigid labor code, the dominance of administratively determined public-sector wages in the economy, the economic disincentives to hiring new workers, and a lack of competitive forces to drive productivity gains being the most important.

The Croatian wage structure contains distortions that compensate Government workers at rates well above private sector averages, with the result that the Government wage bill accounts for 11.2 percent of GDP, compared with a 3.6 percent average for CEE countries. Large wage disparities also exist across education levels and occupations, with unionized industry jobs most likely to be at minimum wage levels that approach the poverty line. Unemployment, too, varies with education level, with 10-11 percent of the least educated and skilled unemployed, compared with only 2 percent of university graduates. Surprisingly, however, the highest unemployment is found among "skilled or highly skilled workers", with 19 percent of males and 15 percent of females in this group being unemployed. (This may reflect a definitional problem.) In most worker groups, unemployment rates do not differ significantly by gender; the two exceptions are the group just cited and that of secondary school graduates, with 8 percent of males and 15 percent of

female high school graduates unemployed. Age is also a significant factor, with 29% of the total unemployed workforce between ages 15 and 24.

A particularly surprising aspect of the Croatian labor market is the high number of persons between 25 and 64 who are not in the active labor force. If the numbers can be trusted – and that is unclear – there are 687,000 inactive workers in this age range, compared with 1.4 million members of the active labor force. The explanation is elusive, but among the posited reasons are incentive programs of the early 1990's that led many workers into early retirement, generous (and probably abused) disability programs for war veterans, and poor accountability for claims for various kinds of welfare benefits. It appears that for many people, being on the dole is a preferable choice to seeking employment, particularly in a low-wage job. Also contributing to unemployment are structural rigidities of the labor code that discourage part-time employment, self-employment and small enterprise development.

Jobs and wages are hot topics within the tripartite discussions currently taking place among Government leaders, labor unions and employers' associations. Initiated by the Government to reach a social pact that will ensure the support of both workers and employers for economic restructuring and reform, the talks have yet to result in agreement on specific terms but have at least kept the lines of communication open. USAID will seek opportunities to address labor issues and encourage further progress in the tripartite process, perhaps by sponsoring research and public roundtables on key issues to help develop a common factual platform on which the discussions can take place. We also will explore the special problems of youthful workers just entering the workforce and of women workers to determine how their skills can be updated and better used in the changing Croatian economy.

Other social issues of concern include problems of health care delivery and financial viability of the health care system, sharply declining secondary school enrollment, growing problems of public health (including HIV/AIDS and substance abuse), and trafficking in women. Croatia has a very low level of documented AIDS cases, numbering only a few hundred. However, the actual number is believed to be somewhat higher and growing, particularly with the recovery of the coastal tourism industry. HIV/AIDS awareness is high, as one would expect in a well-educated country, but anecdotal evidence suggests a high level of behavioral risk among young people. The country currently lacks a well-articulated AIDS prevention and public education program, and a recently-released national Strategy for health care reform makes no mention of HIV/AIDS. USAID will undertake discussions with the Ministry of Health and with other donors during the development of our SO 3.4 program to determine whether or not this is a fruitful area for cooperation. Drug abuse is more widely recognized as a growing problem in Croatia, especially among youth, although statistics are not readily available.

There is also some evidence that on a limited scale, Croatia has become a destination country for the illicit trafficking of sex workers. Typically, young women are lured from Ukraine, Moldova and other parts of the former Soviet Union by promises of employment, only to find themselves trapped in prostitution. So far, there have been 97 documented cases in which such women have received assistance with repatriation to their home countries from Croatia through local NGOs, Government agencies and the International Organization for Migration. The Mission will assess the problems of HIV/AIDS, substance abuse and trafficking to determine whether there are needs and opportunities for assistance in these areas.

C. Results Framework

In our preliminary thinking, we expect that this SO will have three Intermediate Results: IR 3.4.1, Improved efficiency of pension and social service delivery systems; IR 3.4.2, Restructured labor market and tripartite social pact; and IR 3.4.3, Improved advocacy and protection for vulnerable groups.

IR 3.4.1: Improved Efficiency of Pension and Social Service Delivery Systems

Under this IR, USAID will provide support to the GOC's public education program for pension reform. As every working Croatian will be affected by the changes in the pension system and will need to take on new responsibilities for saving and investing for retirement, public education is crucial. The first step, voluntary pension savings accounts, will be launched in January 2002, so the public education campaign will be undertaken in 2001. Trustees of the pension investment funds will also be trained under this program. Discussions with the Ministry of Labor and Social Welfare and with the World Bank, which plans a major pension reform loan in 2002, will determine the extent and direction of further USAID assistance in this area. The Mission will also hold discussions on possible assistance with health fund restructuring.

At the local level, social service delivery may be one focus of USAID assistance in selected pilot cities under the Local Government Reform Program, which is managed under SO 2.1. USAID is using regional funds under the American International Health Alliance (AIHA) to conduct two workshops aimed at improving health administration and strengthening community health and primary care systems through the GOC's "Healthy Cities" program. Pending the outcome of these events and requests from the Ministry of Health, bilateral funds may be added to the AIHA regional cooperative agreement for further assistance.

IR 3.4.2: Restructured Labor Market and Tripartite Social Pact

USAID will continue support to Croatia's labor movement through our buy-in to the regional cooperative agreement with the American Center for International Labor Solidarity (ACILS). Current work focuses on promoting labor involvement in economic policy reform, including restructuring and privatization of state enterprises, as well as pension reform. In addition, the Mission will explore opportunities to engage with the Government on reform of labor codes to facilitate part-time employment (a reform that would significantly benefit female workers), deregulation of hiring and firing decisions, and restructuring of unemployment benefits.

To help maintain the momentum of the tripartite discussions among Government, employers and labor unions, USAID is considering a program of support that will involve sponsorship of joint research and policy dialogue on key issues of mutual concern, as well as facilitation of alternative dispute resolution mechanisms. The Mission believes that the development of consensus among the tripartite groups on key reform issues is critical to maintaining the momentum of reform, and is thus prepared to dedicate significant resources to this area if appropriate endorsement is received from the participants. Discussions are beginning, and we expect to finalize our decisions on support to this process by spring 2001.

IR 3.4.3: Improved Advocacy and Protection for Vulnerable Groups

Under this IR, USAID will consider undertaking targeted programs to address special problems of vulnerable and at-risk groups, such as youth, minorities, and victims of violence. In addition, in the later years of the strategic planning period, this IR will be the home for any remaining assistance to war-affected populations now being delivered through SO 3.1.

D. Progress to Date

USAID has supported a labor union program under SO 2.1 since 1995. Initially focused on strengthening Croatia's confederations of trade unions as democratic organizations and ensuring that worker rights were protected, the program encouraged labor participation in a broad-based NGO coalition, Glas 99, that played a key role in electing Croatia's new pro-reform Government. Following the elections, the program changed to address more directly the bread-and-butter issues that increasingly concern workers -- looming job losses associated with enterprise restructuring, non-payment and/or freezing of wages, pensions and other social benefits. When the railroad workers' unions threatened to strike over lack of consultation with labor on restructuring the national rail system, USAID assistance helped broker a dialogue that defused the situation and ensured a labor voice in future decisions. USAID also sponsored a study tour to Poland on pension reform. Union leaders, officials of the Ministry of Labor and Social Welfare, and the Croatian Employers' Association all participated in this visit. Future program activities will strengthen the tripartite process: in December 2000, a union leader from Ireland will travel to Croatia, and in January leaders from labor, Government, and business will travel to Ireland to see how their counterparts have worked together on an economic growth and investment promotion agenda that has resulted in creation of hundreds of thousands of new jobs.

USAID/Croatia participated in the AIHA Health Partnerships program in 1996-1999, establishing partnerships with five hospitals in Zagreb, Zadar and Biograd. These partnerships were highly successful, and contacts between the Croatian and U.S. partners are continuing without USAID assistance.

E. Program Approaches, Development Partners and Sustainability

Discussion of these factors will necessarily await further assessment and program development, and will be presented for USAID/Washington consideration with a fuller SO framework along with the 2002 R4.

4.2 CROSS-CUTTING PROGRAMS

Four cross-cutting initiatives support USAID's overall assistance goal and influence the results under all Strategic Objectives: new initiatives aimed at stemming corruption and promoting advances in Croatia's use of information and communication technology, and ongoing activities in environment and participant training. Given the nature of their impact across the entire country program, all but the information technology initiative will be managed by the Program Office. A staff member in the Executive Office who has expertise in this area manages the information technology (IT) initiative.

A. Anti-Corruption

The Mission commissioned an assessment of corruption in Croatia in October 2000. Its findings, along with those of a World Bank regional study, indicate that Croatia ranks in the middle range of countries on measures of corruption and perception of corruption. Transparency International (TI) this year registered a significant gain for Croatia by ranking it 51st among 95 countries on its corruption index, compared with 74th in 1999. However, it is likely that this change primarily reflected the positive election results, the anti-corruption commitments of the new Government (including its signing of the Stability Pact Anti-Corruption Compact), and the Government-led revelations of corruption in the former regime. While these are important, it remains important to undertake fundamental reforms aimed at minimizing opportunities for corruption.

Focus groups and surveys indicate that Croatian citizens are deeply concerned about corruption and believe it to be a serious problem in a number of Governmental institutions. Most ordinary Croatians are able to cite common experiences with petty corruption such as payment of extra "fees" to lawyers, bureaucrats or public officials to "expedite" transactions such as permits, licenses, property records, health services, etc. Such practices are, in the aggregate, very costly to individuals and society, with the greatest share of the burden falling on the poor. Nonetheless, administrative corruption -- such as bribery and kickbacks among public officials -- is believed to be relatively low in Croatia. According to the World Bank, there is a serious lack of transparency and accountability in public-private transactions and relationships. Croatia is seen to have a particularly serious problem with "state capture," which is defined as excessive influence of special interests and individuals outside the Government on legislation, policy and administration. Such practices inhibit business and investment, as well as other economic and social transactions. Requirements for disclosure of public officials' financial interests would be helpful. The legislative process also requires greater openness and the judiciary greater independence.

Each SO contains elements in its program that serve to reduce opportunities for corruption. For example, SO 1.3 aims to help create transparency and accountability in commercial court procedures, in land and property registries, and in the privatization process. SO 2.1 targets a more efficient and independent judiciary, competitive and responsible media, more transparent and accountable local government, and strengthened NGOs to serve watchdog and advocacy roles. SO 3.1 promotes legal rights such as property restitution and delivery of welfare benefits to returning refugees.

Complementing this "mainstreaming" of anti-corruption efforts, the Mission will undertake a new cross-cutting initiative to promote public awareness, increase citizen demand for sound governance, transparency and accountability, and help the Government meet its

Stability Pact anti-corruption commitments. With the agreement of the Embassy, USAID will initiate and lead a U.S. Mission-wide anti-corruption working group to ensure coordination between USAID's activities and those of other USG agencies, particularly the Department of Justice legal advisor expected to arrive in early 2001. Consultations with Government officials and other donors will identify specific opportunities for assistance, possibly including legislative assistance aimed at financial disclosure by public officials and judges and a freedom-of-information law.

USAID leadership on the working group and management of cross-cutting anti-corruption activities will be placed in the Program Office, which also has the responsibility for coordinating and reporting on all anti-corruption efforts being implemented in the country program.

B. Information and Communications Technology

It is increasingly evident that for countries to be economically competitive, internationally integrated and open to citizen participation, it is necessary to advance into the mainstream of the new global economy through development of modern information and communications technology (ICT). Use of the Internet in the private and public sectors, for example, can revolutionize commerce, Government, education and science. A five-member expert team commissioned by USAID/Croatia assessed the current status of ICT in Croatia and in the Mission's portfolio, and recommended ways that USAID can advance ICT in this country. The team saw a mixed but promising picture for the country, and fertile ground for the development of ICT projects within USAID portfolio.

On the positive side, the ICT assessment noted the strong human capital of Croatia, resulting from a good education system, particularly in technical fields. They also found that Croatia has a modern ICT physical infrastructure already built, with fiber-optic networks throughout the country. Yet the country only has four Internet Service Providers (ISPs), and only 6 percent of the population uses the Internet. Further, the team estimated that about half of computer use in Croatia is in schools and universities, with business use very low and mostly limited to simple word processing and office automation. While there are some 60,000 businesses considered to be in the ICT business, most are retail distributors of equipment and the Government owns nearly 90 percent of ICT companies. There is a virtual Government-owned monopoly of all fixed telecommunication lines and international dialing access. The state telecommunications company (Hrvatski Telekom, or HT) competes on favored terms with private operators in both the ISP and mobile telephone fields. Partial privatization of HT through strategic investment by Deutsche Telekom has not altered this situation. The regulatory body that licenses private operators is chaired by a Deputy Minister and consists mainly of former employees of the monopoly provider.

Relative to neighboring countries such as Hungary and Slovenia, Croatia lags in private sector ICT fields such as software development and e-commerce companies. Impediments to such companies are less specific to the ICT field than to the overall business climate, which constrains SME development generally. USAID is developing a new SME program under SO 1.3 to deal with these issues, and is also considering the ICT business cluster as a target of assistance under the competitiveness initiative.

There is much that USAID can do to accelerate ICT development in Croatia, and some initiatives are already underway. ICT components of projects in all SOs will help

Croatia's economy, strengthen the democratic processes, and facilitate the revitalization of war-torn areas. A number of these are described in the SO narratives within this Strategy. USAID's program already supports use of ICT in various projects -- from court automation and development of independent media to equipping the Government's Office of Displaced Persons and Refugees. Expanding and widening the ICT projects within the Mission's portfolio will benefit the Mission in its programs and Croatia in its development.

Under SO 4.2, the Mission will seek opportunities to advance state-of-the-art ICT through legislative changes and regulatory reform, and cooperation with the Government on a national ICT Strategy and on pilot "e-Government" activities. Details remain to be worked out, but a better legal framework for a competitive ICT sector and for e-commerce are likely targets.

C. Environment

The principal environmental challenges facing Croatia are described in Part I of this Strategy. USAID's support to environmental improvement in the past has been limited to providing resources to a few environmental NGOs and participation in the EcoLinks environmental partnership program. USAID environmental assistance to Croatia over the period of this Strategy will be quite limited when compared to resources likely to be directed to these issues through European Union and World Bank assistance, as well as assistance from European bilateral donors. For this reason, the Mission will include environmental components where appropriate in the activities undertaken through SOs. Examples might include adding environmental due diligence and mitigation assistance to SME credit activities under SO 1.3, and assistance to local governments on preparation of local environmental action plans and improvement of environmental performance in local water utilities, municipal waste disposal and land-use regulations under SO 2.1. If, as expected, USAID's future work to promote international competitiveness of key economic "clusters" includes the tourism sector, USAID could assist in the development of eco-tourism opportunities.

USAID/Croatia will continue to participate in EcoLinks, the regionally-funded environmental partnership program for Europe and Eurasia. In FY 2000, the Mission expanded Croatian participation in the program beyond its original focus on war-affected regions, opening up opportunities for businesses and local governments nationwide to compete for partnership grants. In addition, USAID/Croatia funds were contributed to the regional inter-agency agreement with the Foreign and Commercial Service (FCS) of the Department of Commerce to initiate participation in the technology transfer and trade promotion activities of EcoLinks. FCS will hire an environmental specialist to manage the program in early 2001. Modest Mission funds will be allocated to continuing the EcoLinks relationships for their duration during the Strategy period.

D. Training

Training is a common activity of all SOs and will continue through the entire strategic planning period. Most training is directly related to a particular SO and is budgeted accordingly. However, a modest training budget will be managed as a cross-cutting activity, to permit training support to the cross-cutting anti-corruption, ICT and environmental activities and to permit flexibility. As in the past, USAID plans to continue support to participant training through the regional training contractor of the Bureau. Training

undertaken by SOs through its partners will be logistically managed and supported through a local office of the training contractor.

It is anticipated that nearly all training will be of a short-term nature, such as study tours, short courses and workshops. Past experience has demonstrated that modest training efforts and exposure to different ways of dealing with problems in other countries of the region, as well as in the U.S., can sharply improve skills, attitudes and knowledge and stimulate innovation. Participant training events may be in the U.S., the region or in-country, with selection of activities based on relevance and value to the participant in the context of planned strategic results.

The Program Office will manage the training contract, and the contractor's primary point of contact at USAID will be this Office. A modest core budget will be retained by the Program Office for the cross-cutting initiatives and for urgent requirements or special opportunities that might arise on short notice or involve necessary training not budgeted elsewhere.

